



TASK FORCE ON AGENCY VENDOR CONTRACTING PRACTICES
REPORT ON SOCIAL SERVICE
CONTRACTING PRACTICES

OFFICE OF
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REPORT ON SOCIAL SERVICE CONTRACTING PRACTICES

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Executive Summary

THE HOUSE SELECT COMMITTEE ON VENDOR CONTRACTING initiated legislation in 1998 to study current state social service contracting practices after concerns were raised about misuse of funds by nonprofit entities. The legislation directed the Office of Financial Management (OFM) to convene the nine-member Task Force on Agency Vendor Contracting Practices comprised of two members representing contractors, two members with work experience as state employees, and the remaining members knowledgeable and experienced with state agency contract practices.

Formal review by federal and state auditors had revealed some problems with contractors receiving improper payment, including duplicate payment for the same services. Other problems identified were reimbursement for unallowable costs, failure of contract oversight and monitoring methods to detect problems in a timely manner, and weaknesses in systems for providing effective guidance to contractors. The Task Force was to examine these problems and identify ways to improve statewide practices relating to client social services contracts and provide better accountability of public funds.

The Task Force began formal monthly meetings on August 12, 1998 and met throughout the year until its final meeting on October 12, 1999. It reviewed current state social service contracting practices, researched contracting practices in other states including Texas, conducted surveys, held focus groups, and solicited input one-on-one from state contractors, agency staff, and other stakeholders who have hands-on experience with state contracts. Several work groups comprised of state and local government staff, certified public accounts and nonprofit contractors were formed to analyze specific topics and to advise the Task Force in development of the recommendations. The Task Force focused its work on the issues and problems deemed most critical. Its objective was to offer workable, practical solutions that would reduce or prevent future problems.

The foundation for the Task Force's work was based on several core values:

- Recognizing that state agencies and contractors are doing some things well, and that many, if not most, contractors are meeting state contract expectations and standards.
- Maintaining a balanced perspective that encompasses the need for ensuring high quality service delivery, achieving results, and demonstrating accountability for critical administrative and financial management requirements.
- Focusing on realistic solutions that take into account state fiscal constraints.
- Streamlining processes where practical.
- Ensuring flexibility, acknowledging that a one-size-fit-all solution would not be workable for the magnitude and diversity of state social service programs.

The Task Force reviewed the troublesome cases that provided the impetus for the work of the House Select Committee and the Task Force. The Task Force analyzed the risks involved with social service contracting, the current contracting practices of various state agencies, and the concern for public accountability for the billions of dollars of public funds being spent for such services. Based on the group's review and analysis and the group's core values, the Task Force developed the following Key Findings and Recommendations.

Key Findings

The Task Force identified the following findings as a result of its review:

- There is a need to improve selection methods in award of social service contracts. There sometimes is a lack of adequate analysis of contractor past performance and other relevant factors to ensure award of contracts to capable, responsible contractors.
- Social service contracts often lack adequate accountability expectations in their statements of work including effective measures of accountability, quality and performance.
- State agencies are often not aware of all funding sources used by the contractor to deliver social services. This prevents a clear understanding of who is paying for what and leads to financial compliance problems.
- State agencies generally are not provided adequate resources for effective contract management and monitoring. More priority needs to be given to the development of adequate systems and resources. Contract management and monitoring of social service contracts should be based on risk assessment criteria.
- Monitoring efforts are generally not adequately coordinated within and among agencies, thereby depriving staff of opportunities to detect duplication of services and to implement monitoring efficiencies.
- Based on case studies analyzed, the quality of audits of nonprofits is not adequate to detect and prevent federal and state financial compliance problems, particularly when multiple funding sources are involved.
- The state does not have guidelines for social service contract administration. This results in inconsistent contract management and monitoring and confusion for contractors.
- The state lacks adequate training and other resource materials for staff on how to effectively administer and monitor social service contracts.
- Initial communication of contract requirements and expectations to nonprofit contractors is not always adequate to prevent misunderstandings and ensure that requirements are fully met.
- The state does not always approach its contracting relationship with its contractors as a coordinated effort to provide quality services to its clients. Communication between the state agencies and contractors needs to be further developed.

Recommendations

To address these issues, the Task Force recommends the following initiatives:

1. **Provide Resources for State Agencies** – The state should provide guidelines on contract administration of social services. The guidelines should be issued through the Office of Financial Management (OFM) and include such topics as: methods of contractor selection, types of contract provisions, effective contract management and monitoring, explanation of contract cost and financial provisions and types of audits and requirements related to them. State subject matter experts, with OFM's coordination, should provide training to state agencies on these guidelines. Other resources should also be developed to supplement the training and be made available through multiple media, including the internet. Draft Contract Administration Guidelines For Social Service Contracts prepared by the Task Force are attached as Appendix B.

2. **Authorize Risk-Based Auditing** – The Legislature should repeal Chapter 232, Laws of 1998 (ESSHB 2881), which requires audits by the State Auditor's Office of nongovernmental entities with state contracts. The Task Force carefully considered the fiscal impact and benefits of this legislation and strongly believes that an alternative approach is preferable.

The alternative approach fixes responsibility for audits of nonprofit and for-profit entities delivering state-funded social services with agency program officials. Recognizing the magnitude and diversity of state programs, imposing a one-size-fits-all audit requirement on nonprofit and for-profit entities is not workable or cost effective. Program officials should be responsible for assessing risk and imposing audit requirements if needed to achieve accountability for the use of public funds. The cost of any audit that is imposed should be borne by the program.

State law and the Office of Financial Management's State Administrative and Accounting Manual provide adequate legal structure for the handling of public funds by state officials. As a check and balance, state programs are subject to audit by the State Auditor on a cyclical basis.

3. **Offer Resources to Contractors** – The state should offer through OFM training to social service contractors to inform them of state agency contracting requirements. Curriculum development should be contracted out and finalized in collaboration with state agency staff, and the training provided by a consultant or other appropriate entity. A resource guide based on the training curriculum should also be available to contractors in multiple media format.

Agencies should give consistent assistance to social service contractors to prevent or remedy contract compliance issues. Part of this assistance should include opportunities for contractor feedback and input.

4. **Improve State Agency Coordination** - An interagency quality improvement team should be formed among key state agencies to develop methods to improve coordination of contract monitoring and management of social service contracts. The team should focus initially on specific issues related to contractors with multiple state contracts. Once this has been addressed, the team should address other quality improvement initiatives suggested by social service contractors. These include, but are not limited to, more effective and consistent information on contracting opportunities, uniform requests for qualifications and proposals, uniform contract documents, consistent rating criteria, improved timeliness of contract

execution and payments, standardized reporting requirements, and coordinated interagency contract monitoring and auditing.

A central contract database should be created to consolidate contract information from agencies' existing databases. The database should contain information on the results of contract monitoring, contractor performance, and audits. OFM would be responsible for the development and maintenance of the system.

The Task Force believes these recommendations will help improve state social service contracting practices in several ways:

- ✓ ☐ Resource materials and training tools will be available to state staff and social service contractors to increase their contracting expertise and reduce the potential for serious contracting problems.
- ✓ ☐ Contract administration quality will be improved as contracts clearly define accountability expectations and as agencies become aware of all funding sources used by the contractor prior to entering into the contract.
- ✓ ☐ Risk-based contract management, monitoring, and audit will give greater attention to higher risk areas and result in more effective use of state resources.
- ✓ ☐ Coordinated monitoring and information sharing among state agencies will allow state and contractor resources to be used more efficiently, cut costs, and enable state agencies to more readily detect and address potential problems.
- ✓ ☐ More streamlined and predictable contracting processes among state agencies will significantly benefit social service contractors delivering services for the state.
- ✓ ☐ Greater accountability for public funds can be achieved.

Costs

Contracting for social services is an effective means of providing services to state agency clients. Social service contracting, however, does come with risks and costs. Effective contract management and monitoring require careful oversight by trained state agency staff. Systems need to be in place that can help state staff effectively manage these responsibilities. State agencies need to coordinate their monitoring when contractors are using multiple funding sources to deliver a package of services. As demonstrated by the audit of the Washington State Migrant Council, monitoring that focuses on a single funding stream may fail to detect compliance issues that can only be effectively examined by looking at the entire funding picture. Contractors need to understand state contract compliance requirements.

It is a difficult and complex process to quantify the fiscal impact of the Task Force's recommendations. The perceived costs must be balanced against benefits that include such intangible factors as regaining public trust in government, reducing questioned audit costs, and minimizing litigation. Also, information regarding state losses is limited and, in some cases, still undetermined as audit findings are being challenged and resolved.

Risks and Liabilities

One method of analyzing the potential risks to the state is to look at the state's financial responsibilities, amount of federal and state funds spent in the last biennium on contracted social services, and losses the state has incurred.

- Under federal law, the state is held to a high degree of accountability for all the federal funds the state spends. The state must comply with a multitude of laws, regulations and other compliance requirements. Any discovered unauthorized use of federal funds must be reimbursed to the federal government within a limited period of time. If a contractor is reimbursed for unallowable costs the state must pay these costs back to the federal funding source and then try to collect the funds from the contractor.
- By state law, state agencies are responsible for maintaining a system of internal controls and internal audits that will safeguard its assets, check the accuracy and reliability of its expenditures, promote operational efficiency, and encourage adherence to prescribed managerial policies and procedures. State agencies are responsible for ensuring that funds spent for contracted social services are properly spent and that quality services were provided.
- Over \$8 billion was spent for contracted social and medical services during the 1997-1999 biennium. This amount has grown by over 144 percent during the past decade, and it is reasonable to assume that the trend toward increased contracting will continue.
- Audits of the Washington State Migrant Council found that the Migrant Council had received at least \$6.7 million in excess funds from state and federal sources. The actual amount that will be charged to the state has yet to be determined. Other recent audits have also had findings of unauthorized costs. In the case of Touchstones, the overpayment debt to the state of \$93,000 was written off in 1998. Even using an estimated risk factor of one-half of one percent of the \$8 billion spent, the risk per biennium could be \$40 million.

State agencies oversee the spending of billions of dollars each year for contracted social services. Some of the funds are federal and some are state. However, in both situations the state agencies are held to a high degree of accountability for those funds. Recent well-publicized cases reflect the losses the state has incurred.

Benefits

There are many benefits to be gained by adopting the recommendations of the Task Force, but they are difficult to quantify. Some potential benefits are:

- The prevention or reduction of actual state losses incurred by overpayments, legal expenses, collection expenses and state staff time. Unfortunately, these types of expenses are nearly impossible to quantify.
- Public perception of state government will be improved as state government adopts sound business practices that would prevent or reduce the number of well-publicized cases.
- Contractor relations would be improved and service delivery for the clients would be more efficient.
- Potential contract problems would be resolved early in the contracting process, thereby mitigating the potential losses.

It is evident that the contract management, monitoring and auditing practices of state agencies need to be strengthened. The risks to the state are very high, both financially and from the perspective of public sentiment towards state government.

The Task Force put forth a good faith effort to provide annual estimated cost impact information for implementation of the recommendations. The balancing of benefits versus additional costs to the agencies has been a difficult task. A number of agencies indicated that the recommendations could be implemented within existing resources. Other agencies were able to identify specific additional costs. Unfortunately, not all the information from all the agencies will be available until the middle of November. The Task Force, rather than submitting incomplete information in this report, will provide a comprehensive cost benefit analysis as a supplemental document by December 1, 1999.



CHAPTER 1

Introduction: Context of the Task Force's Work

The legislature finds that the practice of engaging nonprofit entities to provide social services by use of fee-for-services and/or client services contracts has become necessary to effective state agency operations. The legislature further finds that there is a need to fundamentally examine how state contracts of this type are managed. Thus, the legislature intends that a comprehensive study take place that will identify methods for improving statewide practices relating to fee-for-service and client services contracts.

**Chapter 231, Laws of 1998
(Engrossed Second Substitute House Bill 2880)**

WASHINGTON STATE, LIKE OTHER STATES, contracts with many nonprofit organizations, local and tribal governments, and private for-profit entities to provide a wide range of social services to state residents. During the 1997-99 biennium, the state of Washington spent over \$8 billion to provide social and medical services through client service contracts with public and private organizations. The amount paid to providers for such services has grown by over 144 percent during the past decade; by comparison, the state's total operating budget expenditures have grown 45 percent during the same time period.

On any given day, social service contractors working on behalf of state agencies will:

- Help elderly citizens and individuals with disabilities continue living at home by providing assistance with household chores and personal care, delivering "meals on wheels," or providing transportation to doctor's appointments.
- Provide emergency housing, food, or utility payment assistance to families dealing with a short-term crisis.
- Assist Workfirst participants and low-income job seekers to acquire basic literacy, job, and life skills needed to secure and retain family-wage employment.
- Contribute to the mental, physical, and emotional development of pre-school age children through early childhood education, health, nutrition, and child care services.
- Enable low-income people with substance abuse problems to overcome their addiction through intensive residential or outpatient services.
- Offer health education, prevention, and early detection services to address potential health issues for individuals who lack insurance.
- Provide a safe place to live and grow for children when serious and chronic problems prevent them from remaining with their families.

- Aid individuals with limited English language skills in using governmental services by providing an interpreter.
- Support the rehabilitation and community re-entry of juvenile offenders with comprehensive services offered in secure, group home facilities.

These are just a few examples of contracted social service activities that demonstrate the significant role played by nonprofit, for-profit and local government entities to help the state meet its objectives.

Contracting is the preferred method of delivery for certain programs and social services for a variety of reasons. In a number of cases, particularly with federally funded programs, the state is used as a vehicle to pass through funds for community-based services. Where the state has discretion, decisions to contract are driven by preferences for:

- Providing locally based service delivery that is close to the client.
- Encouraging and supporting partnerships between the state and community.
- Pooling and leveraging resources.
- Achieving greater efficiency and cost effectiveness.
- Limiting growth in state government.
- Maintaining flexibility to expand, reduce or redirect services.

“Few changes in funding and service delivery over the past 50 years have had as profound an effect on both the public and private, not-for-profit social service sectors as has purchase of service contracting.”

— Peter M. Kettner and Lawrence L. Martin
 “Purchase of Service at 20: Are We Using It Well,”
 Public Welfare, 1994

National studies suggest that contracting has become the major mode of state social service delivery. Data from Washington State agencies support this perspective; for example, the Department of Social and Health Services indicates that over 50 percent of its biennial budget is used to pay providers for services to department clients. And with the continuing interest in privatization by government at all levels, it is reasonable to assume the trend toward increased contracting will continue.

Concerns Give Rise to Task Force

In 1997, the Washington State Legislature, alarmed by reports of misuse of state funds by some state-funded nonprofit agencies, established the House Select Committee on Vendor Contracting to review the adequacy of laws and policies of the state that govern vendor contracting and the performance of vendor services. The seven-member committee held a series of hearings to gain a better understanding of state social service contracting practices and reviewed findings from the State Auditor’s Office which indicated that, in several instances, contractors had received improper payments.

As a result of its examination, the House Select Committee initiated legislation to give the State Auditor's Office the authority to conduct audits of contractors receiving state funds; and to establish the Task Force on Agency Vendor Contracting Practices to further assess and provide recommendations to strengthen social service contracting practices. The Task Force was charged with considering a series of questions related to contracting and to report its findings to the legislature and director of the Office of Financial Management by November 1, 1999. (NOTE: The term "vendor" in the title of the task force generally means "contractor," rather than the definition of vendor as used by the federal government. Refer to the Glossary.)

Summary of Troublesome Cases

Several well-reported cases provided the impetus for the work of the House Select Committee and Task Force on Agency Vendor Contracting Practices. In each instance, formal review revealed problems with duplicate billings, reimbursement of costs not allowed by contract terms, failure of oversight methods to detect problems in a timely way, and weaknesses in systems for providing effective guidance to contractors. A brief summary of several specific cases is provided below to illustrate some of the social service contract issues that have surfaced in recent years.

- **Touchstones:** In 1995, the State Auditor's Office (SAO) initiated an examination under the Whistleblower Act of state and other governmental contracts with Touchstones, a private nonprofit agency based in Seattle. The SAO found that DSHS had reimbursed Touchstones for costs that were unallowable because the same costs had been double or triple billed to other funding sources. Reimbursement had also been provided for unallowable personal expenses of two Touchstones managers. Due to the inadequacy of financial records, the SAO was unable to determine the extent to which the state may have reimbursed Touchstones for unallowable costs. The SAO investigation also found that Touchstones had been administratively dissolved by the Secretary of State's Office in 1992 due to its failure to meet annual reporting and license renewal requirements. Touchstones eventually ceased operation and, following unsuccessful efforts to recover funds paid to Touchstones, its state debt of \$93,000 was written off in 1998.
- **Yakima Housing Foundation:** At the request of the City of Yakima and the State House of Representatives, the State Auditor's Office completed an agreed-upon procedures review of the Yakima Housing Foundation in 1997. The review began following the preliminary report of a private audit that identified several financial problems. The SAO reported several instances where the Foundation had billed the city for unallowable costs due to duplicate billings, charges for unauthorized general administrative expenses, activities that did not meet grant criteria, and costs in excess of supporting invoices. The report also suggested that monitoring practices had not been adequate to detect financial and management problems present at the Foundation. The Yakima Housing Foundation ceased operation in 1997.
- **Washington State Migrant Council:** Following a report by the Yakima Herald-Republic indicating that the Council had generated significant surplus funds in its early childhood and child care programs, the Superintendent of Public Instruction's Office and State Auditor's Office conducted audits of the Migrant Council. The audits found that the Migrant Council had received at least \$6.7 million in excess funds from state and federal sources used to support these services. A separate federal review by the U. S. Department of Health and Human Services is due to be completed shortly. The state reports also indicated the need to improve

various Council financial management practices, and addressed weaknesses in contract oversight and coordination between state and federal funders.

Experience in Other States

In establishing the Task Force, Washington joined a number of states that have taken steps to address perceived weaknesses in their social service contracting systems. Research on the efforts of other states found issues similar to those identified by the House Select Committee.

- **Massachusetts:** In 1987, the state of Massachusetts began a contracting practices reform initiative. Responding to a legislative mandate to “implement a consistent, efficient and accountable system for agencies of the Commonwealth which contract for social and rehabilitative services,” the state created an Office of Purchased Services to develop uniform regulations, policies and procedures; establish a uniform financial reporting system; and improve its service pricing practices. Continuing efforts during the past ten years have focused on increasing the effectiveness of contract oversight through monitoring; improving the private audit system; and moving to performance contracting. The Office of Purchased Services provides ongoing coordination and technical assistance support.
- **Colorado, Maryland, Michigan:** Recognizing that weak contract oversight stems, in part, from a lack of training and adequate staff skills in contract administration, the states of Colorado, Maryland, and Michigan have sought to strengthen their contracting systems by focusing on increasing the skills of state staff responsible for contract administration. In Colorado, this has included the development of a contract management guide and training for over 1,000 state staff. An Interagency Contract Improvement Team provides ongoing advice and assistance via a quarterly newsletter and other support resources.
- **Florida:** Following a series of problems with state human services contractors, the state of Florida adopted legislation in 1998 to create designated contract management units and increase the number of staff available to develop and oversee contracting for the Department of Children and Families. The legislation also made significant changes to procurement rules applicable to the department. Separate legislation was also passed establishing a state single audit act.
- **Texas:** The state of Texas is continuing its efforts to improve the contracting practices of health and human service agencies in response to a critical review from the State Auditor’s Office. Legislation recently sent to the Governor for action is intended to strengthen the role of the state’s Health and Human Services Commission to guide and coordinate the contract administration practices of the state’s various social services agencies. Actions mandated include a single risk analysis procedure, a contract management handbook to establish consistent contracting policies and practices, and a central contract management database.

“Successful contracting requires devoting adequate attention and resources to contract development and monitoring . . . In this and previous reviews of privatization efforts, we found that monitoring contractors’ performance was the weakest link in the privatization process.”

Social Service Privatization
United States General Accounting Office, 1997

The Work of the Task Force

The Task Force on Agency Vendor Contracting Practices was organized in July 1998 with the appointment of nine members representing state agencies, local governments, and nonprofit contractors. All members have extensive knowledge and experience with state agency contracting practices. Its mission has been to undertake a thorough review of state contract administration systems, and to address the questions raised in Chapter 231, Laws of 1998 (E2SHB 2880) with detailed, practical, and well-reasoned recommendations.

The Task Force's Responsibilities Under Law

In Section 4, Chapter 231, Laws of 1998, the state Legislature outlines the responsibilities of the Task Force. The complete legislation is included as Appendix A of this report.

The Task Force was directed to review and propose legislative and administrative recommendations on the following issues:

- Adequacy of chapter 39.29 RCW in governing agency contract management and specifically the appropriateness of the exemptions in RCW 39.29.040 (4) and (6).
- Process improvements that provide adequate contract oversight and provide accountability for taxpayer moneys.
- Audits of nonprofit organizations as authorized under RCW 43.88.570.
- Appropriateness or necessity of uniform contract guidelines, as exemplified by those adopted in other states.
- Adequacy of current contract requirements and practices for contract management, monitoring, and auditing.

The Task Force was authorized to use a cost-benefit analysis in preparing its recommendations.

The Approach Taken by the Task Force

As the Task Force began its work, it was mindful of the charge given to it by the Legislature. While the scope of its responsibilities was broad, the Task Force was encouraged by legislators to be flexible and concentrate its efforts on the issues and problems deemed most critical. Most importantly, the Task Force embraced the central intent of the Legislature: to develop workable, practical solutions that would reduce and prevent future problems. The Task Force also recognized that agencies may be subject to federal funding rules and/or to specific state statutes that would mandate specific contracting practices.

The Task Force surveyed state agencies responsible for social service contracting to develop a profile of current contracting practices. Research was conducted to examine what other states have done to strengthen social service contracting practices. Obtaining the perspective of nonprofit contractors was a key objective. A survey of contractors and a series of focus group discussions with nonprofit representatives were completed to identify significant issues.

Based on its initial assessment, the Task Force formed four work groups to help develop its recommendations in the following areas:

- Contract administration guidelines.
- Training and technical assistance.
- Coordination.
- Audit.

As with the Task Force membership, recruitment of work group members was designed to achieve diverse participation and representation from stakeholders actively involved in the state's contracted social service delivery system. A Task Force member chaired each work group.

Several core values provided the foundation for the Task Force's work:

- Recognizing that state agencies and contractors are doing some things well, and many, if not most, contractors are meeting state contract expectations and standards.
- Maintaining a balanced perspective that encompasses the need for ensuring high quality service delivery, achieving results and demonstrating accountability for critical administrative and financial management requirements.
- Focusing on realistic solutions that take into account state fiscal constraints.
- Streamlining processes where practical.
- Ensuring flexibility, acknowledging that a one-size-fits-all solution would not be workable for the magnitude and diversity of state social service programs.

Based on these principles, the Task Force has developed several recommendations for improving state social service contracting practices.

The Task Force focused on practical, workable, easy to implement and cost efficient recommendations with an emphasis on preventing problems. The Task Force discussed the issues of remedies and/or sanctions and deferred making any formal recommendations in this area. A copy of the Issue Paper on whether the Task Force should recommend contract legal remedies and/or sanctions is included in Appendix D of this report.



CHAPTER 2

Key Issues Facing Social Service Contracting

IN THE COURSE OF ITS EXAMINATION, the Task Force reviewed the work of the House Select Committee, consulted with practitioners familiar with the contract administration system, and considered the results of research conducted by staff. Drawing on these resources, and the practical experience of its own members, the Task Force developed the following assessment of critical issues and challenges affecting social service contracting.

Contractor Selection and Contracting

“State respondents also readily admit that the performance standards being used in their contracting processes are often poorly developed, weak or ill conceived.”

Deborah A. Auger
“Privatization, Contracting and the States: Lessons from State Government Experience,”
Public Productivity and Management Review, 1999

Finding #1: There is a need to improve selection methods in award of social service contracts. There sometimes is a lack of adequate analysis of contractor past performance and other relevant factors to ensure award of contracts to capable, responsible contractors.

The Task Force does not believe that client service and fee-for-service contracts should be made subject to procurement requirements now applied to personal service contracts under Chapter 39.29 RCW. Use of a competitive procurement process for services needed by the state is, in many instances, a key mechanism to ensure that the state receives the best value for those services. However, the complex, diverse, and often emergent needs of the state’s social service clients require greater flexibility in award methods. A competitive process, while the preferred approach in general, should not be required as the only procurement mechanism to use in selecting social service contractors. Expedited action may be required to prevent a client from experiencing a crisis situation. In some instances, either due to specialized needs or geographical location, few contractors may be available to the state agency to serve clients’ needs. Meeting the diverse needs of an often fragile client population is a vastly different contracting environment than exists for other types of services the state purchases.

The Task Force concluded that the current legislative policy that exempts client service contracts from procurement and filing requirements is appropriate. Changing current law would not add value. Rather, the Task Force has recommended other approaches in this report to improve the state’s contracting methods for social services.

What is important to ensure is that state agencies use procurement methods that are open, fair, thorough, and objective and result in award of contracts to contractors that are responsible and well qualified to meet state service objectives and that will comply with contract requirements. Agencies should continue their efforts to improve selection practices, including considering past performance as a key criteria in the award decision. Readily available information on the track record of, and any unresolved problems with, individual contractors would be a useful tool to aid agency decision making.

As part of its contract monitoring improvement initiative, the Department of Social and Health Services (DSHS) is developing a central contract database that will include information, such as monitoring and audit findings, which will assist in future contracting decisions. Ideally, such information would be compiled and available to all agencies. DSHS has also used a financial assessment that evaluates the structure and financial stability of prospective contractors.

Social service contractors when surveyed offered additional suggestions to strengthen current procurement methods such as:

- Disseminating information on contracting opportunities more widely.
- Standardizing application requirements.
- Ensuring consistent application of proposal review and selection criteria.
- Conducting selection processes in a timely fashion and reducing delays between contractor selection and contract start.

Finding #2: Social service contracts often lack adequate accountability expectations in their statements of work including effective measures of accountability, quality, and performance.

“State managers need to keep in mind that the transfer of responsibilities for service implementation from government to for-profit or nonprofit providers does not lessen their responsibility for the outcomes of the service enterprise. Agency managers are ultimately the ones accountable for the results of services, even when the service delivery process resides in others’ hands. Despite the critical nature of service accountability questions, state experience shows that administration and oversight of contracted services remained the Achilles’ heel of state privatization efforts.”

Deborah A. Auger
*“Privatization, contracting and the states: Lessons from State Government experience,”
Public Productivity and Management Review, 1999*

Contracts are an essential management tool designed to ensure that state agencies receive intended services. As discussed below, contracts are the primary mechanism used to define service and management requirements, and become the basis for monitoring and oversight. When contracts are poorly written, they are difficult to monitor, evaluate, and audit.

While agencies generally appear to pay more attention and devote more resources to supporting the contracting function than other contract administration activities, there is room for improvement in the quality of contracts. Contractor observations indicate that state contracts tend to be less specific on performance expectations and outcome measures than those of other organizations. Contractors also have encouraged the state to make contract requirements clearer and more consistent.

Although there is increasing interest in and use of performance or outcome-based contracting methods, the Task Force does not recommend mandating use of performance-based contracting for all social service contracts. Basing payment to the contractor on achievement of complex social behavior change is not feasible in all social service contracting circumstances.

However, the Task Force recognizes the benefits of performance contracting and strongly encourages agencies to enter into such contracts whenever it is practical and when funding source requirements would not conflict. Performance or outcome-based contracting focuses on results instead of activities, and prioritizes accomplishments instead of processes. This type of contract generally provides a more meaningful way of assessing what the state gains as a result of its investment. Performance contracts are a key feature of the state's Workfirst programs. However, as demonstrated by the experience of local governments, United Way organizations, and other states, performance contracting requires extensive investment in development of good measures and benchmarking systems, monitoring methods and tools, and training to familiarize all parties with the principles and practices applicable to such systems.

Finding #3: State agencies are often not aware of all funding sources used by the contractor to deliver services. This prevents a clear understanding of who is paying for what and lends to financial compliance problems.

Contractors delivering services for the state of Washington may receive funding from multiple sources. The combination of sources can be from federal and state agencies directly to a contractor and from federal agencies through state pass-through agencies to a contractor. The combination can also include requirements for matching public funds with public funds or public funds with private funds.

It is important for state agencies to understand the total funding a contractor expects to have in delivering public services for a given period of time and the compliance requirements that pertain to each funding source. This information positions the contractor and the funding agencies to reach consensus on financial accountability and program performance expectations, compliance requirements, and/or waivers from compliance requirements.

State agencies are encouraged to be innovative and assertive in partnering with federal and state agencies in planning efficient and effective program service delivery and in ensuring accountability for public funds. To the degree authorized, state agency officials should work with other funding agencies to negotiate waivers from compliance requirements that are in conflict, that are duplicative, or that do not promote operational efficiency and effectiveness.

“Work with contractors in advance to plan how multiple funding sources can be used to provide services. Since funding from a specific contract may only cover a portion of the true cost, contractors and agencies need to work in partnership to determine how resources can be coordinated and avoid the types of problems that have been highlighted by audit findings.

— Nonprofit Contractor, 1999

While funders generally agree that combining multiple resources can enhance the scope and quality of services, more attention should be paid to the issue. When multiple fund sources are used, consistent guidance on how such resources should be tracked and administered must be provided.

Achieving better coordination of state contract administration practices has emerged as a key issue in Task Force discussions. Addressing the challenges posed by the legitimate use of multiple funding sources to meet public goals is one aspect of this issue; another aspect is coordinating program requirements where necessary. Ensuring that these situations are recognized in advance and dealt with when contract requirements are being established is critical.

The Task Force strongly believes that agencies should work with contractors at the time of contract award to identify other sources of funds that may be used along with state contracted resources. Then, in partnership with the contractor, the parties must reach consensus on the cost allocation principles, measurable deliverables, allowability of costs, terms of reimbursement, compliance requirements, and other accountability expectations to ensure that fees and expenses are billed appropriately. It is critical that the contract be specific relative to requirements applicable to the handling of public funds and any legal or regulatory waivers that may have been granted.

Contract Management and Monitoring

Finding #4: State agencies generally are not provided adequate resources for effective contract management and monitoring. More priority needs to be given to the development of adequate systems and resources. Contract management and monitoring of social service contracts should be based on risk assessment criteria.

Effective monitoring requires adequate planning and sufficient resources. Planning is required to assess contract risks, to prioritize monitoring efforts, and to determine the most appropriate means and tools to effectively monitor contractor performance and compliance with requirements. Sufficient resources means that staff have adequate skills and access to specialized assistance or training as needed to effectively monitor contractor deliverables and performance. Contract oversight requires a commitment of sufficient time and effective coordination of all personnel involved in monitoring and follow-up activities. Contractors must also understand how contracts will be monitored and evaluated. The Legislature, Governor, state agencies, and program managers must consider the importance of effective contract management and monitoring and must allocate adequate resources to carry out this responsibility.

The Task Force strongly believes that a well-thought-out, risk-based approach to contract monitoring can be successfully employed to target areas of greater need and make the best use of limited contract oversight resources. Risk assessment looks at risks associated with a particular program or provider, such as program complexity, size, total funding, and past performance and matches monitoring and auditing needs to the perceived level of risk. Higher risk programs or contractors receive greater attention and lower risk programs or contractors are given more limited oversight.

Clarifying monitoring expectations, providing effective monitoring models, and increasing the expertise of staff charged with monitoring responsibilities are needed actions. Past and current efforts to strengthen monitoring activities, such as the work being done by DSHS's Division of Alcohol and Substance Abuse and Children's Administration, offer potential models. However, in some cases, contract management and monitoring activities may be hampered by a lack of sufficient staff resources. Where gaps exist, the Task Force believes it is an agency responsibility to allocate adequate resources to enable it to effectively manage its contracts.

Finding #5: Monitoring efforts are generally not adequately coordinated within and among agencies, thereby depriving staff of opportunities to detect duplication of services and implement monitoring efficiencies.

A number of contractors have contracts with several programs or agencies. To date, there have been few efforts to coordinate contract oversight either within or between agencies. As a result, there is duplication of effort for certain types of monitoring work, such as review of contractor administrative and financial systems.

Coordinated monitoring is one recommendation offered by contractors. Concentrating monitoring efforts would make better use of state resources and reduce the time required of contractors to support state monitoring. The Department of Community, Trade and Economic Development, through its coordinated monitoring quality initiative team, developed a standard intra-agency tool and strategy to improve and centralize its fiscal and administrative monitoring responsibilities.

Another issue that needs to be addressed through coordinated monitoring is the situation where contractors are using multiple funding sources to deliver a package of services. As demonstrated by the audit of the Washington State Migrant Council, monitoring that focuses on a single funding stream may fail to detect compliance issues that can only be effectively examined by looking at the entire funding picture. Team monitoring approaches, such as those used by the DSHS Children's and Juvenile Rehabilitation administrations, should be established where it makes sense. Coordination with non-state entities, such as federal agencies or local governments, may be beneficial as well.

Coordination among state agencies is a key concern of contractors. It was the issue cited most frequently by contractors responding to the Task Force survey on state contracting practices.

Strategies suggested by nonprofit contractors to improve contracting practices are:

- Interpret contract requirements consistently.
- Standardize reporting requirements, where practical.
- Establish a mechanism to allow monitoring and audit findings to be consolidated and shared among state agencies.
- Create a central clearinghouse for contracting and compliance documents required by agencies.

Finding #6: Based on case studies analyzed, the quality of audits is not adequate to detect and prevent federal and state financial compliance problems, particularly when multiple funding sources are involved.

Many, if not most, nonprofit organizations that contract with the state are required to obtain annual audits since much of their funding comes from federal programs. Funders' requirements typically determine the level of auditing expected. For example, nonprofits that meet certain requirements and spend \$300,000 or more in federal funds must receive an annual, entity-wide audit that is performed by an independent auditor and meets the standards of Office of Management and Budget (OMB) circular A-133. The A-133 audit (commonly called a federal single audit) examines whether the entity's financial statements are fairly represented and may be relied upon; assesses internal controls; and tests compliance with federal laws, regulations, and contract requirements. Other funders, such as United Way organizations, and larger county and municipal governments, frequently require an audit or financial review as well.

In 1998, the House Select Committee developed legislation, adopted by the Legislature and signed by Governor Locke, that established requirements for audits of state-funded contracts. Under policies and procedures to be defined by the State Auditor's Office, comprehensive audits would be completed for selected social service contracts with nongovernmental entities. Selection methods would include both a random annual selection of a statistically representative sample, and a risk-based selection according to minimum factors identified in the statute.

“(T)he widespread yet unfounded expectation remains that a financial statement audit ensures adherence to an implied standard of financial rectitude – that it is an enforcement tool designed to uncover all irregularities.”

Charles F. Tate
“The Truth About Audits,” Association
Management, 1996

The legislation also gave the Auditor the authority to conduct “red flag” audits when there is reasonable cause to believe a misuse of state funds has occurred. Limited funding was appropriated to the State Auditor to conduct at least one red flag audit requested by the Legislature; no funds have, as yet, been provided to implement the other provisions of the legislation.

What concerns the Task Force is the fact that audits which met federal standards failed to identify and report the types of problems revealed through special audit work conducted by the State Auditor's Office and others. For example, until the Office of Superintendent of Public Instruction (OSPI) audit of 1998, audits completed for the Washington State Migrant Council did not indicate

that the federal migrant education program funds awarded through OSPI were not being used as intended by the terms of the contract between the Migrant Council and OSPI.

The risk-based approach employed by independent auditors is intended to provide an efficient and cost-effective means of auditing federal programs. As described by the Utah State Auditor Auston Johnson, “This process allows federal agencies the opportunity to build on the single audit, or to concentrate their efforts on problems identified by the non-federal auditors.”

Despite the difference in perspective concerning what single audits are designed to produce, the Task Force believes that efforts need to be made to address several underlying factors affecting the quality of audits:

- Lack of a common understanding between audit users (auditors, nonprofits, and funders) concerning the expectations for audits and needs of audit users.
- Insufficient experience with government nonprofit audits, particularly in smaller firms that perform such audits on a limited basis.
- Lack of understanding on what is covered by existing audit requirements and a lack of knowledge on how to review and use audit information.
- Inadequacy of materiality standards used by independent auditors to determine whether to report deficiencies or questioned costs (taking into account public accountability of the auditee; legal and regulatory requirements; and the visibility and sensitivity of government programs, activities, and functions).

It is worth noting that assessing the quality of single audit work performed by independent auditors is one of five priorities to support successful implementation of the Single Audit Act Amendments of 1996. The federal Office of Management and Budget identified this in its recent testimony before the U. S. House Subcommittee on Government Management, Information, and Technology.

Action to Support the Contract Administration System

“Contracting is one of the most difficult methods a public organization can choose, because writing and monitoring contracts require so much skill.”

David Osborne and Ted Gaebler
Reinventing Government, 1992

Finding #7: The state does not have guidelines for social service contract administration. This results in inconsistent contract management and monitoring and confusion for contractors.

In general, little guidance is provided for the full range of responsibilities associated with contracted social service delivery including contractor selection, contract award, contract management, monitoring, and audit. Where available, existing policies and guidelines tend to focus on the

procurement process and contract document. As a result, state staff responsible for contract administration functions receive limited standard information concerning essential expectations and best practices. In addition, contract administration practices are inconsistent, both within and among state agencies. The Task Force believes that guidelines for state agencies that help clarify social service contract administration expectations and identify ways of ensuring effective practices would be of significant value.

Finding #8: The state lacks adequate training and other resource materials for staff on how to effectively administer and monitor social service contracts.

The lack of contract administration training for state staff is an underlying issue affecting many of the problems identified by contractors, state legislators, and agency staff. Contract administration skills are generally learned on the job. More specialized training is needed to effectively prepare state staff to perform their contract responsibilities and equip them to provide good guidance and support to contractors. Contractors note that turnover of state staff has a significant impact on the success of the contracting relationship. As expressed by one contractor, “All aspects of contracting tend to be smoother when staff handling the activities are more skilled and experienced.”

Several state agencies have begun to develop the types of training and support systems that will increase staff skills. DSHS’s Central Contract Services has established a series of classes covering all aspects of contracting. The Department of Health’s Grants Management Section has created an Intranet site to provide easily accessible resources to increase the knowledge and awareness of standards and issues related to federally funded grants and contracts.

Finding #9: Initial communication of contract requirements and expectations to nonprofit contractors is not always adequate to prevent misunderstandings and ensure that requirements are fully met.

The contract document is used as the primary instrument for establishing contractor requirements and expectations. Often contracts are considered “quite vague” and may fail to make important requirements and expectations clear to the contractor.

Responsibility for providing guidance is often diffuse. The state lacks standard training methods to familiarize contractors with contract management requirements, relying instead on “oral tradition” as a means of communicating critical information. In addition, there is a lack of consistency by state agencies in the interpretation of contracts. As described by some contractors, the contract is seen as a moving target and changes “depending on who you’re talking to.”

“Contractors come with tremendously varied backgrounds and experiences with state contracting. Without an organized, unified approach to convey contract requirements, contract management and service delivery practices will remain inconsistent. It will remain difficult to establish and manage accountability.”

— A State Agency Staff Person, 1998

Up-front training, guidance, and assessment are needed to ensure that contractors have the capacity to meet state contract expectations. “After-the-fact decisions” are a source of frustration, and the Task Force believes that contract management problems brought to light in recent months could have been avoided by providing more effective guidance prior to the start of the contract. The lack of resources to assist contractors in meeting state contract management requirements is a concern of contractors. Training of particular interest to contractors includes guidance on using multiple funding sources and assistance in developing performance management systems.

Some state programs have developed effective models to ensure that contractors have a good understanding of state requirements. Pre-contract training provided to Workfirst contractors and the Developmental Disabilities Council’s practice of completing an on-site review within the first 30 days of contract start are examples of proven methods for ensuring that contractors are familiar with contract requirements.

Finding #10: The state does not always approach its contracting relationship with its contractors as a coordinated effort to provide quality services to its clients. Communication between the state agencies and contractors needs to be further developed.

Contracting for social services differs significantly from other types of contracting performed by state agencies. Social service contracting relies more heavily on mutual trust, adaptability, and quality of service. Longer term relationships are typical and, in some cases, essential. Certain services, such as residential care, require significant capital investment by contractors that would not occur without some certainty of the state-contractor association.

Areas of particular concern to contractors regarding their contracting relationship with the state are:

- One-sided contract negotiation – contractors want more input in determining the expectations and requirements included in contracts. They generally think state agencies do not offer a reasonable approach to negotiating contract terms.
- Administrative requirements need to be reasonable – allowable indirect rates used to support administration are frequently inadequate to meet state administrative requirements. Contractors, too, do not have sufficient resources to meet burdensome administrative requirements. Some contractors indicated the amount of administrative time required can exceed the value of the contract and that the state holds them to a lower indirect rate than the rate they can substantiate.
- Lack of timely payment – ensuring adequate cash flow is an important issue to nonprofit contractors. Smaller organizations in particular have limited reserves; timely payment is essential to maintaining service capacity.

“(H)uman service programs are very complex, require good working relationships between the contractor and several state agencies, and need to be customized and responsive to change.”

— Richard H. Beinecke and Robert DeFillippi
“The Value of the Relationship Model
of Contracting in Social Services”
Public Productivity and Management Review, 1999



Overview of Task Force Recommendations

THE PURPOSE OF THIS REPORT is to share the preliminary proposals and recommendations that have been developed by the Task Force over the past 12 months. In many respects, the state's social service contract administration system works fairly well. Unlike other states that have faced major deficiencies in their contracting systems, Washington has experienced relatively few high profile breakdowns in contractor accountability. However, as the Legislature recognized, recent experience has brought attention to the need to do better. Given the state's growing reliance on contracting as a means of addressing vital human service needs, actions that can be taken to strengthen and improve social service contracting practices are a reasonable and prudent investment to assure taxpayers that public dollars are used wisely.

No single action taken independently will serve as *the* remedy in a complex system with so many components and players. That is why the Task Force has examined and suggested a series of steps directed to the needs of: 1) state staff responsible for developing and managing social service contracts; 2) contractors responsible for delivering the services and meeting state contract expectations; and 3) others such as independent auditors and state oversight agencies that perform specific roles in support of the social service contract administration system.

The Task Force's recommendations, which are described in greater detail in the following chapters, can be grouped into three central themes:

- Increasing the expertise of those responsible for making the social service contract administration system work well.
- Addressing the perceived gaps in the state's social services contracting and contract oversight structure.
- Promoting coordination and information sharing within and among agencies to establish more effective oversight and reduce duplication of effort for contractors that contract with multiple state agencies or programs.

Increasing Expertise

The Task Force believes that adequate guidance and training are needed to provide the foundation for a solid contract administration system. To this end, the Task Force recommends the following actions:

- Issuance of "best practice" guidance on social service contracting by the Office of Financial Management (OFM) and state social service agencies, based on the contract administration guidelines developed by the Task Force.

- Provision of a standard contract administration training curriculum coordinated through OFM for state contract, program and fiscal staff responsible for agency social service contract practices, augmented as needed by additional specialized training based on demand.
- Delivery of a standard contracted services financial management training curriculum for contractors coordinated through OFM.
- Development of a social service contract administration resource guide for social service contractors developed by OFM.
- Provision of technical assistance on state contracting requirements for contractors.

Anticipated Result

What is the expected result of recommendations to increase expertise? Weaknesses in the state's social service contract administration system can often be traced to a lack of effective guidance. Dedication resources to improving the knowledge and preparation of state staff and contractors to fulfill their respective responsibilities can be expected to reduce problems resulting from inadequate information and training. More uniform guidance will help define expectations of state agencies for administering and monitoring social service contracts. Equally important, more uniform guidance will help contractors be successful in meeting the state's expectations for service delivery and handling public funds.

Addressing Gaps in Contracting and Contract Oversight Structure

Strengthening contracting practices by attending to key issues of concern to legislators, executive managers and contractors was a Task Force priority. Through its work on the draft guidelines and recommendations related to management and audit of state funded contracts, the Task Force recommends the following approaches:

- Accountability for all aspects of contracting and contract management should be assigned by state agencies to specific agency staff.
- State agency contracts should be clearly written and results focused, and should include well defined, measurable expectations and compliance requirements.
- Agencies should gather information on all funding sources to be used by the contractor to meet contract service requirements prior to contract execution. Contract expectations related to the use of multiple funding sources should be determined in advance and well understood by both the state agency and contractor.
- State agency program officials should be responsible for establishing requirements for monitoring and financial compliance auditing, based on a risk-based assessment, for social service contracts.
- State agency program officials should follow-up on the resolution of monitoring and audit findings and recommendations until they are satisfied that resolution has been achieved.

- State agencies program officials should follow-up on the recovery of overpayments and unallowable program costs until they are satisfied recovery has been completed in the public interest.

Anticipated Result

These recommendations take into account the lessons learned from past experience. Clearer, more consistent contracts will provide greater assurance that agencies and contractors have a mutual understanding of the compliance expectations and requirements that will be used as a basis for monitoring and auditing. Ensuring that plans to use funds from multiple sources for a service are well defined in advance will help agencies understand how services will be supported or enhanced, and avoid issues related to potential duplicate billing or inappropriate and inadequate cost documentation methods. A risk-based approach to contract management will allow agencies to make good decisions regarding the best mix of oversight activities needed to track contractor performance and contract compliance. Targeting oversight resources will give greater attention to higher risk programs and contracts and promote efficient use of state social service contract administration dollars. Timely resolution of monitoring and auditing findings as well as recovery of public funds inappropriately paid to contractors is in the contractor's and public's best interest.

Promoting Coordination and Information Sharing

While information is not available as to the number of contractors that work with more than one agency or program, Task Force members believe sufficient overlap exists to warrant efforts to coordinate contracting and contract oversight activities between agencies and programs. The Task Force perceives that improved coordination can best be accomplished by forming an on-going interagency quality improvement team to:

- Design and implement a common approach for monitoring contractor fiscal and administrative compliance requirements. Program and service delivery requirements would continue to be monitored separately by individual agencies and programs.
- Organize inter- and intra-agency efforts to conduct joint monitoring and follow-up, as needed, to provide technical assistance and resolve monitoring findings.
- Address other opportunities to coordinate and streamline contracting documents, requirements and processes.

To support and facilitate sharing of information on contractors, the Task Force also proposes the development of a central database of contracts for social services.

Anticipated Result

Greater coordination of agency contracting and contract management activities for contractors that work with multiple state programs or agencies could produce the following benefits:

- Common standards and tools to address shared contract accountability and compliance needs.

- More efficient use of state and contractor resources by reducing duplicative monitoring efforts and providing coordinated follow-up.
- More effective monitoring, which enables state agencies and contractors to detect and correct any billing or cost allocation problems.
- Reducing the impact of monitoring and auditing requirements on contractors by centralizing and sharing information through a central database.



Contract Administration Guidelines

Key Recommendations

- Guidelines developed by the Task Force for contract administration address five major areas: contractor selection, contract provisions, contract management and monitoring, contract cost and financial provisions, and audit. (See Appendix B.)
- The Task Force recommends the guidelines be implemented as an OFM publication that provides best practice guidance for state agencies.

THE 1998 WASHINGTON STATE LEGISLATURE, in E2SHB 2880, directed the Task Force to consider whether uniform contract guidelines were appropriate or necessary as a means of improving statewide practices relating to client social service contracts. The absence of uniform contract management guidelines was one of the primary issues identified by the House Select Committee on Vendor Contracting.

In its review of current state agency contracting practices, the Task Force found that few agencies have established standard policies and procedures for social service contract administration. This lack of guidelines has led to inconsistent practices among agencies with inconsistent results. Previously, agency contract staff have recommended the state establish clear standards, guidelines and expectations on how to monitor and administer client service contracts.¹ Department representatives interviewed by Task Force staff believe uniform guidelines could be helpful; however, agency staff are sensitive to potential requirements which might increase the complexity or workload of the current social service contract administration system.

The Task Force reached early agreement concerning the need to develop clearly defined expectations for social services contract administration. Its objective was to develop easily implemented consistent guidelines that could be embraced by all agencies and adapted as needed to address individual agency and program needs. A work group was formed and given the charge of drafting recommended contract administration guidelines.

Several working principles were established by the work group to guide its efforts. The work group recognized that state agencies and programs may have existing requirements that drive their contract administration practices; maintaining flexibility and enabling agencies to continue efforts to simplify processes and procedures were important goals. The work group intended that the guidelines be used to communicate key expectations, essential agency responsibilities, and provide direction on effective contracting practices to ensure accountability for the performance of contracts and the expenditure of public funds. Equally important was the intent to avoid prescribing specific

¹Washington Association of Contract Specialists, Recommendations for improving acquisitions/contracting processes and procedures, January 15, 1998.

procedures or requirements. The guidelines offer suggested approaches and stress the responsibility of agencies to determine appropriate policies and procedures necessary to satisfy their responsibilities and promote the effective and efficient use of public funds.

Information gathered from other states that have developed uniform guidelines was reviewed and considered by the work group as it drafted its recommended guidelines. Additional material from Washington State agencies, federal agencies and private sector sources was also used. Feedback from state nonprofit contractors concerning areas where state contract administration practices could be improved was considered as well.

The guidelines developed by the work group include a set of guiding principles for state administration of client social service contracts as follows:

Accountability: State agencies are accountable for ensuring that cost-effective, quality services are provided to their clients by agency contractors. Responsibility for all aspects of contract administration, management, oversight and audit should be assigned to specific staff.

Fiscal responsibility: State agencies are responsible for ensuring that public funds are used as intended and contractors' expenditures are adequately documented. State agencies should identify all contractor funding sources to help prevent duplication of payments.

Collaboration: Delivery of social services is a collaborative effort between the State and its contractors.

Contractor Selection: Selection methods should provide state agencies the flexibility they need to ensure timely quality services are delivered and encourage the participation of well-qualified contractors.

Well-qualified contractors: Contractors providing social services are to be well-qualified to meet service delivery, contract compliance and fiscal management expectations.

Effective oversight: State agencies are responsible for monitoring contractor performance to ensure compliance with funding and contract requirements and to take action in the event of noncompliance.

Leadership and Guidance: State agencies should provide leadership, policy direction, training and/or technical support to agency and contractor staff to ensure effective and efficient administration of state administered contracts.

The guidelines address five major areas of contract management:

- Contractor selection.
- Contract provisions.
- Contract management and monitoring.
- Contract cost and financial provisions.
- Audit.

The Contract Administration Guidelines for Social Service Contracts are presented in Appendix B of this report.

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Audit Requirements

Key Recommendations

- The Task Force recommends the state employ a risk based approach to set audit requirements for contractors providing social services.
- The Task Force recommends that responsibility for establishing audit requirements for social service contracts be transferred to state agencies.
- Audits of social service contractors should be funded as a program expense.

Chapter 231, Laws of 1998, directed the task force to consider several specific questions related to audits of nongovernment organizations that contract with state agencies for the delivery of social services:

- What size of contracts should be subject to auditing requirements?
- What other factors should be used to set audit requirements?
- How should audits of nongovernment contractors be funded?
- What improvements need to be made to current practices and requirements regarding audits and financial reporting?

Presently, subrecipient social service contracts funded with federal pass-through dollars are subject to audit based on the requirements of the Federal Single Audit Act. The Office of Management and Budget sets Federal audit standards; the requirements for not-for-profit organizations are included in OMB circular A-133. Contractors that meet the annual expenditure threshold (currently \$300,000) and other criteria, and that receive federal funds through the state, are required to provide A-133 audit reports to the state agencies that contract with their organization.

In 1998, the Washington State Legislature enacted E2SHB 2881, which amended provisions of state law concerning audits of state funded social service contracts. A key reason for the bill was legislative concern that existing contract oversight and management procedures “cannot ensure that services under contract are delivered effectively and efficiently.” The bill made state-funded contracts subject to audits based on selection procedures administered by the Office of the State Auditor.

Under the requirements of RCW 43.09.055 and 43.88.570, the State Auditor selects two groups of nongovernment entities from reports submitted by state agencies, based on random sampling and risk assessment factors. The randomly selected contractors are required to obtain comprehensive entity-wide audits in accordance with Generally Accepted Government Auditing Standards (GAGAS). Contractors selected under risk based factors will be audited by the State Auditor’s

Office directly or by a certified public accountant selected by the State Auditor. The State Auditor may also conduct audits when there is reasonable cause to believe that a misuse of state money has occurred.

Audits are one element of an effective social services contract oversight structure. To address the questions raised by the legislature, the Task Force formed a work group to consider what types of audit requirements might be appropriate for state social service contracts. The work group reviewed the audit provisions created by E2SHB 2881 as well as single audit models used by the other states and the federal government.

Uniform State Single Audit Models

A number of other states have adopted, by legislation or administrative rule, uniform single audit standards for social service contracts, often based on the federal model. In some cases the state has incorporated supplemental audit standards, or developed an agreed upon procedures standard, that addresses federal requirements as well as specific state needs.

A sample of states with single audit requirements were asked to provide information on why uniform audit requirements were established. The following summarized comments were received:

- **Improved accountability and oversight:** In several states, the legislature identified the need for standard audits as a means of improving oversight for contracted state services and providing assurance that state funds were properly spent. In some instances, legislative action was preceded by a state auditor's report indicating weaknesses in the state's contract administration systems.
- **Streamline and consolidate audit requirements:** Uniform single audit requirements were established to eliminate duplicative and confusing audit requirements used by individual departments or programs, and to improve and coordinate audit policy and compliance guidance.
- **Limited staff resources:** Lack of sufficient staff to monitor and audit contracted programs was noted as an issue in some states. Audit reports are relied on as a source of monitoring information and used to concentrate monitoring on areas (and contractors) where greatest need is indicated. A couple of states indicated they have problems providing sufficient staff resources to follow up on audit findings and corrective action plans.
- **Increased knowledge of contractors:** Audits help state agencies "know" their contractors. Audits also tell agencies whether a contractor has adequate internal controls, their ability to comply with contract requirements and about the accuracy of financial reports.

Office of Management and Budget (OMB) Circular A-133

Under A-133, nonprofits spending \$300,000 or more in federal funds during a fiscal year are required to procure an annual entity-wide audit. Biennial audits are allowed under certain circumstances. Many, if not most, nonprofit contractors work with a mix of federal and state funds, and are already subject to A-133 audit requirements. Over 80% of the nonprofit contractors responding to the Task Force survey on state contracting practices indicated their organization has an entity-wide audit completed on an annual basis.

To minimize the impact of additional requirements and maintain consistency with an existing standard familiar to most nonprofits and independent auditors, work group members felt that any state audit requirements should be consistent with and build on the A-133 framework, where practical.

What Audit Requirements Should Be Established For Social Service Contracts?

Several questions were central to the work group's discussion of audit requirements for social service contracts:

- To what extent is there a gap in audit coverage? What state funds are not presently covered by current audit requirements?
- What is the risk the state is trying to address?
- What value is added by increased audit requirements?
- What is the cost of increased audit requirements? Will additional requirements reduce funds available for client services?

The work group discussed the potential value and issues related to a uniform state single audit requirement. Possible benefits include:

- Consistency and uniformity of audit requirements;
- Increased integrity of oversight systems;
- Lower risk of inappropriate use of funds or noncompliance with program and contract requirements;
- More responsible treatment of state dollars;
- Potential dollar savings by avoiding duplicate efforts; and
- Potential to recover funds used for ineligible expenditures.

A number of valid concerns were raised as well:

- Implementing a uniform single audit requirement on a large scale would be a significant undertaking that would require several years' experience to realize potential benefits. The cost impact of developing and implementing systems to support uniform state audit requirements and the increased auditing costs need to be determined and weighed against expected benefits.
- Are the problems with social service contracts significant enough to require an expansion of audit requirements? The attention given to this issue is driven by a limited number of known problem situations.
- Addressing limitations in current agency monitoring capacity is important; expanded auditing provisions should not be established at the expense of needed investment in support systems (e.g., enhanced training, access to specialized expertise) for compliance and fiscal monitoring.

Ultimately, the Task Force considered two alternative approaches to audit requirements:

- A uniform single audit requirement which would apply to all nonprofit and for-profit contractors that annually expend state funds above a set dollar amount.
- A targeted, risk based approach similar to the features of the model established by the Legislature in E2SHB 2881.

Risk-Based Audit

Taking into account probable risk and key state interests in ensuring accountability for the expenditure of state taxpayer dollars, the Task Force determined that the targeted, risk based approach is the better alternative. While a uniform single audit approach offers consistency, it would also result in higher auditing and audit-related administrative costs and more audit coverage than is truly needed. It may also be less effective in addressing specific state accountability needs.

Recommended policy decisions and actions to support implementation of a targeted, risk based auditing approach for contracts funded with state dollars include:

- State agency program officials should be assigned the responsibility to determine audit requirements on a program or contractor basis. The agency decision should be based on a consistent risk-assessment framework that is used to establish overall contract oversight requirements, including monitoring and audit. The overall audit objective needs to be the determination of the allowability and eligibility of expenditures.
- Audit requirements should be applied only to those contracts that would meet the definition of a subrecipient relationship, as used by federally funded programs. Contracts that meet the definition of a vendor relationship should not be subject to audit requirements. Additional guidance to help agencies to distinguish subrecipient and vendor determinations, as applied to state funded contracts, should be developed.
- Audit requirements should be incorporated in the contract agreement. The contract should specify audit expectations in sufficient detail to enable the contractor and its independent auditor to know, in advance, internal control and program compliance requirements. State audit requirements should take into account and avoid duplication of audit procedures that would be performed as a result of other audit requirements applicable to the contractor. An example would be A-133 audit components such as the entity wide examination of internal controls.
- State audit requirements should take into account probable subcontracting relationships. In such cases, subcontractor audit requirements should be developed in consultation with the contractor.
- Risk-based approach means the agency determines whether an audit is appropriate based on analysis of risk factors associated with the contract. Audit is authorized only when the agency determines that an audit is advisable given the analysis conducted. Cost is not the determinant factor in a risk-based analysis.
- Risk-assessment criteria should take into account the total state dollars expended by the contractor. However, a set dollar threshold should not be the sole criteria used to determine state contract audit requirements. Agencies should consider risk-assessment factors, as

identified in the Task Force's draft contract administration guidelines (Appendix B), when assessing risk.

- Audit is not to be used in lieu of monitoring the contract. Timely contract monitoring is key to ensuring contract requirements are being fulfilled and to helping prevent major problems.
- Audit costs for state funded social service contracts should be treated as a program cost. The audit cost charged to the state should be no more than its pro-rata share of total funding.
- Where feasible and necessary, agency program staff should consider practical and workable means of coordinating audit requirements for contractors using multiple funding resources to deliver services for the state.
- Where audits, contract oversight procedures or other information indicate potential abuse or misuse of state funds, state agencies are responsible for conducting or contracting for additional review or audit.

The Task Force recommends the State Legislature consider the transfer of responsibility from the State Auditor's Office to state agencies to select social services contractors for audit based on risk-assessment criteria. The Task Force believes the State Auditor's Office should continue to play a role to assist state agencies in implementing audit requirements and provide technical assistance and support. Where requested and funded, the State Auditor's Office should also continue to have the authority to perform audits. However, the Task Force believes that routine decisions regarding audit requirements for state funded contracts should be determined by state agency program officials.

This approach will allow the state to develop audit requirements that are risk-based, fully taking into account the scope and adequacy of other oversight activities (i.e., agency monitoring efforts, contractor reporting requirements, etc.), and will balance the need to divert limited program resources with the state's need to ensure accountability. Several actions will be needed to support implementation of the Task Force's audit recommendations.

Training

Training should be provided to state agency program staff that enables staff to determine what types of audit requirements should be incorporated in social service contracts and to make effective use of audit report results. The training should cover:

- Orientation on "what is an audit" and different types of audits (financial audit, single audit, program audit, agreed upon procedures audit).
- The differences between auditing and monitoring, and what information is or is not provided through an audit.
- How to use risk assessment to determine appropriate audit requirements.
- How to coordinate audit efforts and benefits of coordination.
- How to define audit requirements in contracts.

- How to review and use audits including: reviewing for completeness and quality; analyzing audit issues (findings and questioned costs); and assessing contractor corrective action plans.
- Audit follow up and resolution processes.

Potential training needs for contractors and auditors on social service contract audit requirements should be assessed as well.

Guidelines

The Task Force included an audit section in the Contract Administration Guidelines for Social Service Contracts that offers general guidance on setting contract audit requirements.

Legislation

Based on the feedback to draft audit recommendations, the Task Force recommends that the Legislature should repeal RCW 43.88.570. The Task Force carefully considered the fiscal impact and benefits of this legislation and strongly believes that an alternative approach is preferable.

The alternative approach fixes responsibility for audits of nonprofit and for-profit entities delivering state-funded social services with agency program officials. Recognizing the magnitude and diversity of state programs, imposing a one-size-fits-all audit requirement on nonprofit and for-profit entities is not workable nor cost effective. Program officials should be responsible for assessing risk and imposing audit requirements if needed to achieve accountability for the use of public funds. The cost of any audit that is imposed should be borne by the program.

State law and the Office of Financial Management's State Administrative and Accounting Manual provide adequate legal structure for the handling of public funds by state officials. As a check and balance, state programs are subject to audit by the State Auditor's Office on a cyclical basis.

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State Staff Training

Key Recommendations

- The Task Force recommends standard contract administration training be provided for state agency staff with social service contracting and contract management responsibilities.
- The Task Force recommends training be supplemented by a guidelines workbook and supporting resources on topics of special interest.
- The Task Force recommends that responsibility for facilitating, developing and delivering training and technical support be assigned to the Office of Financial Management.

MOST STATE STAFF RESPONSIBLE for social service contract administration currently learn the skills and knowledge needed to perform these duties on the job. Until recently, little formal training was provided by individual state agencies. (DSHS's Central Contract Services has begun delivering training on a variety of contract administration topics in the last two years.) Most agencies indicated that a lack of resources has limited their ability to provide training beyond what has been delivered through on-the-job consultation.

Based on an informal survey of contract office representatives from key state social service agencies, there appears to be general agreement that a standard contract administration training curriculum would help strengthen the capacity of state agency staff to effectively manage and administer state social service contracts.

"We (state agencies) do not necessarily make sure that staff responsible for contract management fully understand the responsibility that goes along with the assignment."

— Task Force Member, 1999

The training approach suggested would be similar to the HELP Academy model offered by the Department of Personnel on human resource and employment law issues. HELP training is based on current case law on employment related issues and provides state managers training based on real life situations. Agency representatives estimate that about 800-1000 state agency staff could be targeted for participation in contract administration training.

Contract Administration Training

A standard curriculum should be developed to provide consistent information and guidance on best social service contract administration practices. This standard curriculum would be modeled around the topics covered in the draft contract administration guidelines developed by the Task

Force. To help minimize costs and ensure the training content reflects specific state interests, the Task Force suggests that a team of state agency representatives could deliver much of the training.

The core curriculum should be supplemented with more intensive training on specific topics based on agency interest and demand. These topics should be identified through consultation and feedback from training participants; however, topics likely to be of particular interest include:

- Effective social service contract statements of work and performance measures.
- Performance-based contracting for social services and how to measure outcomes.
- Cost allocation and documentation, with an emphasis on appropriate approaches for using resources from multiple sources.
- Social service contract risk assessment and oversight, including monitoring methods.
- Audits and the audit resolution process.

The Task Force recommends the training needs to be cost-effective and practical, focusing on actual best practices and case studies.

Contract Administration Guidelines Workbook

Resource materials that can be used in conjunction with training or accessed for individual use as needed should supplement formal training. Resource materials should be provided in hard copy form and through electronic means (similar to the Internet resource directory made available by the HELP academy). One specific tool suggested is the development of a contract administration guidelines workbook. Supplemental, topic-specific materials should be made available as needed, and materials developed by individual agencies, other states or outside resource organizations could be used as well.



Contractor Training and Technical Assistance

Key Recommendations

- Offer financial management training for social service contractors.
- Develop and provide a resource guide for social service contractors.
- Provide technical assistance to social service contractors with the goal of helping them meet contract expectations and requirements.

THE TASK FORCE RECOMMENDS THREE ACTIONS to help strengthen the capacity of contractors to effectively manage and administer state social service contracts. It is recommended that the Office of Financial Management coordinate implementation of these recommendations.

State social service contracts should require contractors to meet a complex mix of accountability requirements. Typical accountability expectations include:

- Serving the intended target group effectively (services that meet client needs).
- Conforming to relevant service delivery standards (services that meet state specifications or regulatory requirements).
- Achieving expected service results (clients receive or achieve the desired outcome).
- Demonstrating that contracted funds are used appropriately (contractor financial records show that fees or costs are reasonable, allowable, and necessary).
- Complying with other defined standards of financial and administrative practice (as defined by law, contract requirements and applicable program and agency regulation).

“Annual training sponsored by the state would be extremely helpful.”

— Nonprofit Contractor, 1999

Currently, state agencies devote most of their training and technical assistance resources to assisting contractors in meeting service expectations. Since agency program staff, who may not have expertise in financial and related administrative requirements, generally provide most contractor training and technical assistance, contractors may not receive consistent, useful guidance to help them fulfill their contractual obligations. Nonprofit contractors, particularly smaller organizations, may be very capable of delivering services, but lack sufficient understanding and capacity to meet other accountability requirements.

Both the House Select Committee and the Task Force recognize that problems related to financial and administrative accountability often stem from a lack of knowledge of rules and requirements, and a lack of assistance and training to help contractors address these needs. As a result, the Task Force formed a work group to develop recommendations for addressing these issues.

The Task Force agreed that the highest priority for contractor training and technical assistance services is in the area of financial and administrative requirements. As a result, its recommendations reflect a combination of training and technical assistance services designed to address this specific need.

Uniform Financial Management Training for Contractors

A training curriculum should be developed to provide contractors standard guidance on fiscal management requirements. The curriculum should cover:

- Internal controls.
- Cost allocation including implications of using multiple funding sources.
- Allowability and eligibility of expenditures.
- Billing for services.
- Financial record keeping and reporting for state government contracts.

The cost of creating and delivering standard workshops should be covered by the state. Training should be made available on a periodic basis at multiple locations around the state to make it easily accessible to contractors. Training fees should not be charged; however, contractors should be expected to cover travel and other costs related to participation. It is recommended that curriculum development and delivery be accomplished through a consultant, working in partnership with an advisory team representing state agencies responsible for social service contracting, the Attorney General's Office, the Office of Financial Management, the State Auditor's Office, and contractors.

Several additional training topics have been identified as areas of potential need and interest:

- Performance management systems and performance-based contracting.
- Business practices for nonprofits (i.e., board roles and responsibilities, personnel, insurance, Americans with Disabilities Act, etc.).
- Single audits including how to interpret and use an audit report, hiring independent auditors, corrective action plans, and audit resolution.

State Contract Administration Resource Guide

A resource guide covering what is required to contract with the state, targeted specifically for social service contractors, should be developed and coordinated through OFM. The resource guide would cover:

- Typical state social service contracting processes.
- Typical contracting requirements.
- Fiscal management and administrative systems required to meet contracting requirements
- Contact information for specific types of services.

The resource guide should include a self-assessment tool that enables prospective and new contractors to evaluate their current management and administrative capabilities, and determine whether additional systems are needed to meet contracting requirements. As with the proposed training curriculum, representatives of state agencies responsible for social service contracting and social service contractors should provide advice and guidance for development of the resource guide. The guide should be made available through the Internet as well as in hard copy form.

Agency Based Technical Assistance Support

The Task Force recommends that agencies be prepared to provide technical assistance services to contractors providing social services, if needed by the contractor. This can be accomplished through either dedicated staffing or contracted service delivery or a mix of the two methods. For example, the Department of Health contracts with Certified Public Accountants to review selected contractors' financial systems to ensure that their systems meet state requirements. Department program staff provide all needed program and service delivery support. Where feasible, agencies may wish to establish interagency agreements to share resources to meet this need.

Technical support should be made available to contractors during the contract period when requested by the contractor, or when contract monitoring indicates the contractor may be experiencing a problem meeting contract requirements. In this case, assistance should be provided to assess the situation, provide guidance to remedy the problem and follow up with the contractor as needed to ensure the issue has been successfully addressed.

For entities that are newly formed or new to the agency, it would be appropriate for agency staff to verify that appropriate program and fiscal systems are in place prior to contracting with the entity. Another approach is to enter into a short-term or pilot contract which would allow the agency the opportunity to assess the financial and programmatic capabilities of the organization, prior to entering into a longer term contractual relationship.

Nonprofit Contractor Training and Technical Assistance Work Group

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Coordination of State Contracting Activities

Key Recommendations

- The Task Force recommends forming an interagency quality improvement team to undertake a common approach to monitoring and oversight functions for social service contractors with multiple state contracts.
- The Task Force recommends establishing a central client social services contract database to facilitate sharing of contractor information within and between state agencies.

CONTRACTORS FREQUENTLY WORK with multiple funding sources to provide an effective mix of services to the state's clients. For example, nearly 60% of the contractors responding to the Task Force survey on state contracting practices reported they manage five or more contracts with state agencies annually. However, efforts to coordinate contracting and contract management activities within and between state agencies and programs are limited. Lack of coordination and communication among state agencies and funding sources is a significant contracting issue to both contractors and state legislators.

When asked how the state could improve its contracting practices, a number of contractors suggested actions to increase consistency and coordination such as:

- Standardizing the contractor selection processes.
- Increasing consistency in contract provisions and requirements, definitions, interpretation and reporting.
- Coordinating the monitoring process.
- Consolidating and sharing monitoring and audit findings among agencies.

“The difference between how each of our contracts (is) handled by the state is enormous.”

— Nonprofit Contractor, 1999

In addition, contractors expressed interest in information and guidance on how different funding sources can be integrated to provide a better mix of client services.

Well-considered efforts to coordinate selected contract administration activities have the potential to improve the state's effectiveness in managing contracts, reduce duplicate efforts and achieve savings for state agencies as well as contractors. One example of a successful interagency coordination effort is the quality initiative completed by DSHS's Division of Alcohol and

Substance Abuse and the Department of Community, Trade and Economic Development. Each agency manages funding contracted to county governments to support substance abuse prevention activities. In 1998, the agencies worked together to create a common needs assessment report. Eliminating the duplicate process has saved up to 80 county-level staff hours for each of the nineteen counties that receive prevention funds from both agencies.

The Task Force determined that oversight of contractors with multiple funding sources is a major challenge for state agencies. Currently, agency monitoring activities are, in most cases, undertaken separately by each program, resulting in sometimes duplicative levels of review of the contractor's social service contract management systems. Monitoring too is often focused on a single funding source that is unlikely to detect possible problems with resource "blending," an issue highlighted by the work of the House Select Committee on Vendor Contracting and the State Auditor's Office.

Recognizing the need to improve coordination of state contracting activities, the Task Force formed a work group to develop recommendations which could be undertaken to improve coordination of contract administration and oversight practices.

The work group identified a set of goals, values, and assumptions to guide its discussion of coordination options.

Goals

- Smooth, seamless delivery of services to clients.
- Reasonable coordination with social service contractors.
- Accountability and adequate controls.
- Minimize risk, reduce paperwork and redundant effort/staff hours.
- Coordinated resolution of issues identified through monitoring or audits.

Values

- Standard contractor information that is accurate and up to date.
- Sharing information to help reduce risk.
- Simple is better.
- Accommodate both biggest and smallest agencies.
- Honor existing systems and investment.
- Helpful and of value to agencies and social service contractors.
- Incorporate actions now being taken by agencies.
- Minimal additional statutory requirements.
- Least cost impact.

Assumptions

- No additional administrative resources to make this work.
- We will not be able to build a totally fail-safe system, i.e., no mistakes or fraud.
- To the degree possible, need to work with existing state and federal regulations.

Additionally, the work group recognized that an effective coordination system will be built in stages, and achieve higher levels of collaboration and resource sharing over time. Initial coordination efforts should focus on creating systems for developing and sharing information that address common social service contract administration needs.

Recommendations

The Task Force recommends two initial steps to address selected coordination needs:

- Form an interagency team to develop and initiate coordinated contract oversight activities for contractors with multiple state contracts.
- Create a central contract database that includes all state social service contracts by contractor, which would allow agencies to identify contractors with multiple state contracts.

Interagency Quality Improvement Team

The Task Force believes several improvements to coordinated contract oversight could be accomplished through an interagency quality initiative:

- A common tool for required administrative and fiscal monitoring activities.
- Resource sharing to consolidate and eliminate duplicative fiscal and administrative monitoring activities and to learn about effective methods and tools.
- A system for sharing information on monitoring results.
- Joint review and follow up on monitoring and audit findings.
- A forum for troubleshooting problem situations with specific contractors.
- Additional research on progressive sanctions for contractors.

The team could also serve as the coordinating point for other steps designed to strengthen the state's social service contract systems. For example, the team could play a role in coordinating the development of consistent compliance guidance for state social service contract audit requirements.

All state agencies with responsibility for social service contracting should be invited to participate. In addition, several agencies that play a role or have an interest in state client social service contract administration should be included. Participating agencies might include:

- Attorney General's Office.
- Community and Technical Colleges.
- Department of Community, Trade and Economic Development.
- Department of Corrections.
- Department of Health.
- Department of Services for the Blind.
- Department of Social and Health Services.
- Department of Veterans Affairs.
- Employment Security Department.
- Office of Financial Management.
- Office of the Superintendent of Public Instruction.
- State Auditor's Office.
- Secretary of State's Office.
- University of Washington.
- Workforce Training and Education Coordinating Board.

Federal human service agencies, county human service departments, social service contractors, and citizens should also be invited to participate in this effort.

The Task Force also recommends the team devise appropriate means of measuring the performance of coordinated contract oversight to assess its impact and effectiveness. Possible indicators that might be used to measure the impact include reduction in duplicate monitoring efforts and contractor feedback.

Central Contract Database

The purpose of the proposed central contract database is to provide access to information on contracting activity across state agencies. Most state agencies maintain some type of contract database for social service contracts. Presently, that information is not available outside the individual agency and, in some instances, within agencies. This limits the ability of agency staff to readily identify other agencies or programs that may be contracting with a specific organization.

As initially envisioned, the central database would consolidate a limited amount of contract information from the existing agency databases. If the initial database is successful, based on user input, additional data would be added. Ultimately, the database could include:

- The results of contract monitoring information.
- Contractor program performance information.
- The results of independent audits.
- Status of audit resolution.

The Task Force recommends that development and implementation of the central database be a project undertaken by the interagency team.

“Consolidate and share findings among agencies . . . an easily accessed database where problems and technical assistance gaps could be recognized quickly (suggested ways to improve contract management and monitoring).”

— Nonprofit Contractor, 1999

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GLOSSARY

Agency means any state office or activity of the executive and judicial branches of state government, including state agencies, departments, offices, division, boards, and commissions, and educational, correctional, and other types of institutions. (Chapter 39.29 RCW)

Allocated costs means direct costs that directly benefit more than one contract, program, or function and can therefore be allocated to the benefiting programs based on a reasonable and equitable basis.

Client means a member of the public who the agency has statutory authority to serve, protect or oversee.

Client services means services provided directly to agency clients including, but not limited to, medical and dental services, employment and training programs, residential care, and subsidized housing. (RCW 39.29.006 (2))

Cognizant agency (federally funded programs only) means the Federal Agency responsible for negotiating and approving indirect cost rates for a non-profit organization on behalf of all Federal Agencies.

Contract as used in this report, means any contract for social services.

Cost Reimbursement Contract means a contract that provides for payment of allowable incurred costs to the extent prescribed in the contract. These contracts establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed (except at its own risk) without the approval of the contracting state agency. (48 CFR 16.301 modified for state purposes)

Direct costs means those cost which can be identified with a particular contract, program or cost objective. For example, the entire salary of an individual who spends all of his or her time working on a single contract can be charged as a direct cost to that contract.

Fee for Service Contract means a contract awarded for services to be performed for a set fee or rate.

Fixed price contract means a contract where the contractor is reimbursed a lump sum or fixed amount established in the contract. Typically, payment is tied to completion of deliverables, project milestones, or other specific performance.

Grant means the furnishing by the State of assistance, whether financial or otherwise, to any person to support a program authorized by law. It does not include an award whose primary purpose is to procure an end product, whether in the form of supplies, services, or construction; a contract resulting from such an award is not a grant but a procurement contract. (ABA Model Procurement Code)

Indian tribe means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under the Alaskan native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians. (OMB Circular A-133)

Indirect costs mean costs incurred by a contractor that are not readily chargeable to a particular contract, program or function, but benefit all programs operated by the contractor. Indirect costs are necessary to the overall operation of the contractor, but a direct relationship to a specific contract cannot be shown.

Monitoring means the examination, analysis and verification of the contractor's performance, documenting outcomes in accordance with the contract and progress towards performance goals. Monitoring includes planned ongoing or periodic activities such as reviewing, observing and reporting.

Not-for-profit or a nonprofit organization means a group organized and operated solely for charitable, religious, social, political, educational, civic, fraternal, athletic, or benevolent purposes. No portion of the profits from events sponsored by a not-for-profit group may be paid directly or indirectly to members, officers, directors, or trustees except for services performed for the organization. Any compensation paid to its officers and executives must be only for actual services and at levels comparable to the compensation for like positions within the state. (RCW 66.24.375 modified).

Performance-based contract means a contract where the contractor is reimbursed based on the attainment of specific outcomes or results, e.g., placement of a client into unsubsidized employment.

Procurement means the method used to select contractors and may include both competitive and noncompetitive methods.

Reasonable costs: A cost is considered reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs.

Social services means services provided to agency clients to promote their health and well-being, to help them become more self-sufficient and successful in functioning in society; prevent dependency; strengthen family relationships; and help restore individuals to successful social functioning. Social services include, but are not limited to, English language training, child care, job training, custodial care, residential care, and training to at-risk students. Medical services are excluded unless specifically identified as a social service in the contract.

Subcontract means a contract between a contractor and a third party (subcontractor) to perform part or all of what is required under an underlying contract between the agency and the contractor.

Subrecipient (federally funded programs only): Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Distinguishing characteristics of a subrecipient include, but are not limited to, the following:

- a) Determines who is eligible to receive services.
- b) Has its performance measured against whether the objectives of the state program are met.
- c) Has responsibility for programmatic decision making.
- d) Has responsibility for adherence to applicable State program compliance requirements.
- e) Uses the federal funds to carry out a program of the organization as compared to providing goods or services for a state program. (OMB Circular A-133)

Subrecipient (state funded programs): Subrecipient means any entity that expends state funds to carry out a state program but does not include an individual that is a beneficiary of such a program. Distinguishing characteristics of a subrecipient include, but are not limited to, the following:

- a) Determines who is eligible to receive services.
- b) Has its performance measured against whether the objectives of the state program are met.
- c) Has responsibility for programmatic decision making.
- d) Has responsibility for adherence to applicable State program compliance requirements.
- e) Uses the State funds to carry out a program of the organization as compared to providing goods or services for a state program.

Vendor (federally funded programs only): Vendor means a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a Federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the Federal program. (OMB Circular A-133)

Feedback

Comments received on the draft report:

“... the department supports the draft recommendations, and believes that these recommendations can make a significant improvement in the state’s social services contract administration system. I particularly support the recommendation to form an interagency quality improvement coordinating committee to undertake a common approach to monitoring and oversight functions for social service contractors.” *Mary C. Selecky, Secretary, Department of Health*

“CTED agrees with all of the findings and recommendations in the report and believes that adopting the recommendations would be a positive step . . . Providing flexibility to state agencies to determine exactly how to implement these recommendations is important.” *Kate Heimbach, Assistant Director, Administrative Services, Community, Trade and Economic Development*

“We believe it is not only reasonable but also essential to work toward increasing the expertise of those responsible for implementing the contract administration system. Adopting ‘best practices’ and providing OFM standardized training will be very beneficial for all participants . . . We believe the improved efficiencies gained from the success of these recommendations should be expanded to include other state contracting activities.” *Carver Gayton, Commissioner, Employment Security Department*

“... the guidelines published will assist us in doing a better job of managing our contract requirements . . . In particular, we support the recommendation that state agencies be responsible for determining necessary monitoring or auditing of contracts using a risk-based approach.” *Lyle Quasim, Secretary, Department of Social and Health Services*



Acknowledgments

*It's easy to do the right thing.
The problem is to know what the right thing is.*

Harry S. Truman

THE ESSENTIAL ROLE OF GOVERNMENT is to bring people together to solve problems for the common good. The Task Force benefited tremendously from the advice and involvement of the many interested practitioners that helped develop our recommendations to improve state social service contracting practices. Our product reflects the thoughtful perspective of these experienced individuals who share our commitment to ensuring that Washington's contracting practices support state goals to effectively serve our clients. Their insight, participation and support are deeply appreciated.

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Maggie Moore, State of Georgia

Shirley Moore, Department of Social and Health Services
Steven Moss, Blue Mountain Action Council
Cindy Mund, Department of Social and Health Services
Dan Murphy, Department of Social and Health Services
Denny Naughton, Department of Community, Trade and Economic Development
Gerry Nelson, Department of Social and Health Services
Laura Nelson, Department of Social and Health Services
Roberta Nestaas, Lutheran Social Services of Washington & Idaho
Karin Newgard, State Auditor's Office
Lien Ngo-Tran, Department of Social and Health Services
Cindy Noble, Department of Community, Trade and Economic Development
Thu Nguyen, Department of Social and Health Services
Sharron O'Donnell, Bader Martin Ross & Smith, PS
Eugene Ozust, YWCA of Spokane
Nick Pender, Office of Financial Management
Vicki Petitt, Coastal Community Action
Deborah Photiadis, State of Maryland
Rick Price, Department of Veterans Affairs
Meredith Rafferty, Office of Financial Management
Thomas Rembiesa, Ruth Dykeman Children's Center
Jim Rising, Department of Veterans Affairs
Jim Robertson, Department of Health
Colleen Rozmaryn, Department of Social and Health Services
Wayne Roumseville, Children's Home Society of Washington
Doug Ruth, House of Representatives Office of Program Research
Walt Sachs, State of Florida
Michelle Sanidad, United Indians of All Tribes Foundation
Frances Sant, Secretary of State's Office
Rose Schaller, State Auditor's Office
Marcie Senger, Office of the Superintendent of Public Instruction
Ron Sheaffer, State of Texas
Bill Shuler, Skagit County Community Action
Judy Sloan, Lower Columbia Community Action Council
Peri Smith, Department of Labor and Industries
Janet SooHoo, Asian Counseling and Referral Service
Jeannie Southworth, State of Kentucky
Linda Stone, Children's Alliance
Larry Stuckart, Spokane Neighborhood Action Programs
Maraide Sullivan, State of Connecticut
David Surat, State of Maine
Bob Swanson, Washington State Association of Community Action Agencies
Jim Thomas, State of Florida
Ann Thompson, Department of Health
John Toohey, Office of Financial Management
Lynette Totty, State of Kansas
Kathy Ursich, Children's Hospital
Erwin Vidallon, Department of Veterans Affairs
John Walsh, Community Action Council
Peggy Wojcik, Department of Labor and Industries
Priscilla Wolfe, Department of Social and Health Services
John Young, Employment Security Department



Appendix A: E2SHB 2880



CERTIFICATION OF ENROLLMENT

ENGROSSED SECOND SUBSTITUTE HOUSE BILL 2880

Chapter 231, Laws of 1998

55th Legislature
1998 Regular Session

EFFECTIVE DATE: June 11, 1998

Passed by the House March 10, 1998
Yeas 98 Nays 0



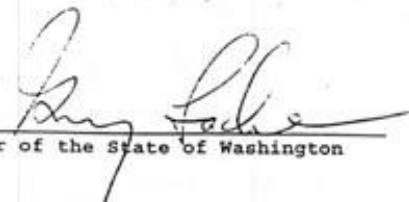
Speaker of the
House of Representatives

Passed by the Senate March 6, 1998
Yeas 46 Nays 2



President of the Senate

Approved March 30, 1998



Governor of the State of Washington

CERTIFICATE

I, Timothy A. Martin, Chief Clerk of the House of Representatives of the State of Washington, do hereby certify that the attached is ENGROSSED SECOND SUBSTITUTE HOUSE BILL 2880 as passed by the House of Representatives and the Senate on the dates hereon set forth.



Chief Clerk

FILED

MAR 30 1998

Time 3:10 pm

Secretary of State
State of Washington

ENGROSSED SECOND SUBSTITUTE HOUSE BILL 2880

AS AMENDED BY THE SENATE

Passed Legislature - 1998 Regular Session

State of Washington 55th Legislature 1998 Regular Session

By House Committee on Appropriations (originally sponsored by
Representatives Clements, Dickerson, Backlund, Gombosky, Parlette,
Gardner and Delvin)

Read first time 02/07/98. Referred to Committee on .

1 AN ACT Relating to state agency personal service contract
2 guidelines; creating new sections; and providing an expiration date.

3 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

4 NEW SECTION. Sec. 1. The legislature finds that the practice of
5 engaging nonprofit entities to provide social services by use of fee-
6 for-services and/or client services contracts has become necessary to
7 effective state agency operations. The legislature further finds that
8 there is a need to fundamentally examine how state contracts of this
9 type are managed. Thus, the legislature intends that a comprehensive
10 study take place that will identify methods for improving state-wide
11 practices relating to fee-for-services and client services contracts.

12 NEW SECTION. Sec. 2. The definitions in this section apply
13 throughout this act, unless the context clearly requires otherwise.

14 (1) "Agency" means every state office, department, division,
15 bureau, board, committee, or other state agency.

16 (2) "Task force" means the task force on agency vendor contracting
17 practices.

1 (3) "Contractor" means any nonprofit entity holding a fee-for-
2 services and/or client services contract or grant for the provision of
3 social services with the state of Washington, as defined in chapter
4 39.29 RCW.

5 (4) "Contract" means any fee-for-services and/or client services
6 contract or grant for the provision of social services as defined in
7 chapter 39.29 RCW.

8 NEW SECTION. Sec. 3. A task force on agency vendor contracting
9 practices is established. The task force shall be convened by the
10 office of financial management and shall be composed of nine members to
11 be appointed by the director of the office of financial management.
12 Two members of the task force shall be chosen as representatives of
13 contractors. Two members of the task force shall be chosen for their
14 personal work experiences as state employees responsible for
15 administering contracts. All other task force members shall be
16 selected for their knowledge and experience with state agency practices
17 governing contracts. The director of the office of financial
18 management shall appoint a chair from among the members of the task
19 force. The task force shall invite and incorporate the participation
20 of interested legislative members.

21 NEW SECTION. Sec. 4. (1) The task force shall review and propose
22 legislative and administrative recommendations for the following
23 issues:

24 (a) The adequacy of chapter 39.29 RCW in governing agency contract
25 management. Such a review shall include, but is not limited to,
26 whether the exemptions contained in RCW 39.29.040 (4) and (6) are
27 appropriate in maintaining agency oversight and accountability for
28 moneys used to engage contractors;

29 (b) Process improvements that ensure adequacy of contract oversight
30 and provide accountability for taxpayer moneys, including the specific
31 roles of the office of financial management and other state agencies in
32 ensuring the accountability of public funds;

33 (c) The appropriate level of state reimbursement which will
34 determine which contractors are eligible to be audited by the office of
35 the state auditor using his/her authority under RCW 43.88.570. The
36 task force shall additionally recommend appropriate funding resources
37 for the office of the state auditor to exercise its authority to audit

1 nonprofit corporations who provide personal services to a state agency
2 or to clients of a state agency, under chapter 43.09 RCW, and
3 nongovernmental entities under RCW 43.88.570;

4 (d) Whether uniform contract guidelines as exemplified by those
5 adopted in other states, such as Texas, are appropriate or necessary,
6 and the adequacy of current contract requirements and practices for
7 contractor selection and award, contract compliance with state and
8 federal standards, contract management and monitoring, accounting
9 methods, payment mechanisms, postcontract procedures, contract legal
10 remedies and performance audits, sanctions to ensure contract
11 compliance, and financial reporting.

12 (2) The task force may utilize a cost-benefit analysis in preparing
13 its recommendations. The task force shall develop proposed procedures,
14 policies, and guidelines, and, if necessary, proposed legislation or
15 administrative rules, to address the issues of its review.

16 NEW SECTION. Sec. 5. The task force, where feasible, shall
17 collaborate with individuals from the public and private sector and may
18 ask such persons to establish an advisory committee. Agencies shall
19 cooperate with the office of financial management and provide the task
20 force with support and assistance necessary to carry out the purposes
21 of this act. The task force may consider the suggestions of agencies
22 in preparing its recommendations, including any findings and
23 information provided by the joint legislative audit and review
24 committee.

25 NEW SECTION. Sec. 6. The task force, where feasible, shall use
26 office of financial management staff and facilities. The office of
27 financial management may hire additional staff with specific technical
28 expertise if such expertise is necessary to carry out the mandates of
29 the study in this act. Each member of the task force is eligible to be
30 reimbursed for travel expenses in accordance with RCW 43.03.050 and
31 43.03.060.

32 NEW SECTION. Sec. 7. By November 1, 1999, the task force shall
33 report its findings to the director of financial management, to the
34 house of representatives vendor contracting and services select
35 committee or to the most appropriate house of representatives standing
36 committee in the event that the vendor contracting and services select

1 committee no longer exists, and to the senate committee on government
2 operations.

3 NEW SECTION. Sec. 8. If any provision of this act or its
4 application to any person or circumstance is held invalid, the
5 remainder of the act or the application of the provision to other
6 persons or circumstances is not affected.

7 NEW SECTION. Sec. 9. This act expires January 1, 2000.

8 NEW SECTION. Sec. 10. If specific funding for the purposes of
9 this act, referencing this act by bill or chapter number, is not
10 provided by June 30, 1998, in the omnibus appropriations act, this act
11 is null and void.

--- END ---



Appendix B: Contract Administration Guidelines for Social Service Contracts

THE TASK FORCE ON AGENCY VENDOR CONTRACTING PRACTICES developed the Contract Administration Guidelines for Social Service Contracts to assist Washington state agencies in contracting for the delivery of social services to their clients. The Task Force was charged by the 1998 Washington State Legislature with the responsibility of providing recommendations for improving state agency contract administration practices; the guidelines are one of several products developed by the Task Force.

Washington state agencies are to ensure that the state receives full value for the tax dollars they spend. State agencies have the responsibility to fulfill this important objective through use of effective and efficient contracting practices. These Contract Administration Guidelines describe the essential responsibilities of state agencies for the administration of client service contracts for social services.

The guidelines presented here apply specifically to client service contracts for social services. Client services are defined in RCW 39.29.006(2) as: services provided directly to agency clients including, but not limited to, medical and dental services, employment and training programs, residential care, and subsidized housing. For the purpose of these guidelines, social services are considered services provided to agency clients to promote their health and well being; to help them become more self-sufficient and successful in functioning in society; that prevent dependency; strengthen family relationships; and help restore individuals to successful social functioning. Examples of social services include: child care, job training, custodial care, residential care, English language training, and training for students at-risk. Medical services are excluded unless specifically identified as a social service in the contract. Social research services provided to study a social problem and which do not provide direct services to agency clients are personal services and are not included in the definition.

Many other types of contracting activities are undertaken by state agencies. The scope of these guidelines, however, is to address contracting activities associated with client social service contracts.

Purpose of the Guidelines

An effective contract administration system is key to success in utilizing public and private sector contractors to provide social services to state agency clients. The purpose of these guidelines is to define the essential responsibilities of state agencies and their contractors to ensure accountability for performance of contracts and the expenditure of public funds. The guidelines are intended for contract managers, program managers, financial managers, and other state agency staff involved with contract administration, management and oversight. The guidelines identify contract administration expectations that should be considered as agencies

determine policies and procedures necessary to satisfy their responsibilities, and promote the effective and efficient use of public funds.

Guiding Principles

Accountability: State agencies are accountable for ensuring that cost-effective, quality services are provided to their clients by agency contractors. Responsibility for all aspects of contract administration, management, oversight, and audit should be assigned to specific staff.

Fiscal responsibility: State agencies are responsible for ensuring that public funds are used as intended and contractors' expenditures are adequately documented. State agencies should identify all contractor funding sources to help prevent duplication of payments.

Collaboration: Delivery of social services is a collaborative effort between the State and its contractors.

Contractor Selection: Selection methods should provide state agencies the flexibility they need to ensure timely quality services are delivered and encourage the participation of well-qualified contractors.

Well-qualified contractors: Contractors providing social services are to be well-qualified to meet service delivery, contract compliance and fiscal management expectations.

Effective oversight: State agencies are responsible for monitoring contractor performance to ensure compliance with funding and contract requirements and to take action in the event of noncompliance.

Leadership and Guidance: State agencies should provide leadership, policy direction, training and/or technical support to agency and contractor staff to ensure effective and efficient administration of state administered contracts.

Deciding to Contract for Services

Certain legal requirements must be carefully considered before contracting for services.

Traditional State Work – State agencies should not contract if the needed service constitutes work traditionally performed by state employees and for which state employees are available. (Washington State Supreme Court ruling in Washington Federation of State Employees v. Spokane Community College, 90 Wn.2d 698, 1978)

Termination of Classified Employees – The contract should not be entered into if execution of a contract would terminate classified employees or classified employee positions currently existing at the time of the execution or renewal of the contract. (RCW 41.06.380)

Collective Bargaining – A social service contract should not be awarded if contracting would adversely affect any collective bargaining agreements.

The agency should seek legal advice from the Assistant Attorney General regarding these or similar situations where legal requirements are uncertain.

Generally, state agencies responsible for social service delivery have a combination of both broad and specific authority to contract for services. Frequently, contracting may be mandated in the authorizing legislation for a specific program or service. Factors that may be considered in determining whether to contract for services include:

- Does the agency or program have the legal authority to contract for the services?
- Does the agency have adequate resources to administer the contracting process and monitor the contractor's performance?
- Does contracting provide the greatest benefit to the state and the clients?
- Are qualified providers available to provide the service to be contracted?
- Does the agency have sufficient or available staff to provide the service?

Contractor Selection

Under current state law, contracts for client services are exempt from the state's competitive selection requirements (RCW 39.29.040). However, federal funding rules, program specific state statutes, or internal agency policy may require a competitive procurement process for certain contracts.

Generally, state agencies have the flexibility and discretion to select contractors by using procurement methods that best meet their needs. Procurement, as used here, is defined as the method used to select contractors and may include both competitive and noncompetitive methods.

Selecting an appropriate procurement method is one means of ensuring the state receives the best value and greatest overall benefit for its clients. The procurement method chosen should demonstrate the following characteristics:

- Supports the achievement of required contract performance outcomes.
- Generates the best quality and economic value.
- Provides the greatest long-term benefit to clients receiving services.
- Minimizes disruption of client services.
- Promotes the participation of capable and responsible providers.
- Allows interested and qualified providers to be considered.
- Encourages competition where practical.

- Is timely and cost effective.
- Is fair, objective and ensures equal treatment of prospective providers.
- Minimizes the burden on administrative resources.

Contractor Qualifications

Contractor screening criteria and methods will vary depending on program requirements and the type of selection process used. Ensuring that contractors are well qualified to meet service delivery requirements and management expectations is a key responsibility of state agencies.

Screening methods should ensure that contractors selected to provide services are able to meet the following standards as they relate to the particular contract under consideration:

- The contractor has the appropriate experience, organization, technical qualifications, skills and facilities, or has the ability to obtain them (including probable subcontractor arrangements).
- The contractor is able to comply with the proposed or required time of delivery or performance schedule.
- The contractor has adequate administrative and financial capability for performance.
- The contractor has a satisfactory record of integrity, judgment and performance.
- The contractor is otherwise qualified and eligible to receive a contract under applicable laws and regulations.

Specific contractor qualifications that should be examined prior to contract award include:

- Appropriate license, registration or authorization to do business in Washington state, and/or speciality licenses or certifications required for the service to be delivered.
- Financial stability.
- Previous contractual performance.
- Minimum or other necessary qualifications relevant to the contracted service including experience, staff qualifications, service and administrative capability, and special requirements (e.g., bilingual capacity, insurance, geographic coverage, etc.).

Licenses, registrations and certifications

Contractors, with the exception of public agencies, must be appropriately licensed to do business in Washington state. Additional specialty licensing, registration or certification requirements may be necessary, depending on the service to be delivered.

Financial stability

Audit reports and financial statements may be used to demonstrate that the contractor has effective financial management practices and internal controls, is in sound financial condition, and that any audit findings have been resolved. Contractors may also be required to disclose details of any debarment action, criminal investigation, indictment or other litigation against the organization, which might adversely affect its ability to complete its obligations.

Previous contractual performance

Past performance will often enable state agencies to better predict the quality of, and customer satisfaction with, future work. References, monitoring and audit reports, or evaluations are potential resources to aid examination of prior performance. Aspects of past performance which may be taken into account include:

- Quality of service, including compliance with contract requirements.
- Timeliness of performance such as adherence and responsiveness to contract schedules.
- Cost controls including staying within budget, and providing accurate and complete billings.
- Business practices and key personnel performance including the track record of the organization and its key staff, compliance with fiscal accountability requirements, and effective working relations between the contractor and the agency.
- Customer satisfaction.

Minimum/necessary qualifications

Minimum or necessary qualifications are determined by the state agency and program based on requirements applicable to the contracted service. Such qualifications may include:

- Experience providing the service and working with the target population.
- Staff credentials and expertise.
- Capability to meet service delivery, program management, and contract administration requirements.
- Other special requirements such as the ability to provide culturally relevant services, in languages other than English when necessary; physical presence or capacity to deliver services in specific geographic locations; insurance coverage; and other qualifications necessary to perform the contract according to agency specifications.

Standards of Ethics and Conduct

State employees contracting on behalf of the state are to maintain strict ethical standards and take caution to avoid any real or apparent conflict of interest. Chapter 42.52 RCW, “Ethics in Public Service,” applies to all state employees.

The ethics law is designed to protect state employees from conflicts of interest or from engaging in activities where their interest or loyalties are divided or may be questioned. Employees should familiarize themselves with the applicable statutes and all agency policies whenever they are involved in any contract on behalf of the state. Agencies should contact their Assistant Attorney General for further information.

Contract Provisions

A good contract is one that is readily understood, clearly describes the services contracted to meet the state's needs, is manageable, and provides a mechanism for measuring the contractor's performance. All contracts should contain, at a minimum, five basic elements:

- Identification of the parties entering into the contract and signatures of the parties' representatives with the authority to bind the parties to the contract.
- A clear description of the work and services to be provided.
- The performance period, including dates when deliverables are due.
- Payment terms, including the rate and timing of pay.
- Terms and conditions, including program and fiscal accountability requirements, as applicable to protect the interests of the parties.

Description of work

The description of work (also known as the statement of work) should be an accurate, thorough, and measurable description of the essential and technical requirements for the services to be provided. The description should include the desired results and standards to be used to determine whether the requirements have been met. Key characteristics of an effective description of work include:

- *Clearly written*; use plain simple English.
- *Results focused*; results or performance should be the focus. Address specific procedure or process requirements only when necessary.
- *Clearly defined expectations*; the contractor should not have to guess what is expected. All aspects of performance should be included.
- *Complete*; cover all issues and express all expectations in sufficient detail.
- *Measurable*; write the performance requirements in such a way that it can easily be determined if and when the contractor has successfully completed performance, and when and how much the contractor should be paid.

Performance measures

Contract performance measures:

- Define the standards for measuring contractor performance.

- Provide a means to monitor performance.
- Measure satisfaction with the provider and client.
- Provide data for program evaluation.

When developing performance measures, consideration should be given in advance to how the data is to be submitted and analyzed. Key questions to be addressed:

- How much information can reasonably be requested, submitted, and analyzed?
- How often and on what schedule must the data be reported?
- How will the information be submitted?
- Who will receive the information?
- How will feedback be provided to the contractor?
- What is the cost and benefit of each proposed performance measure?

Good performance measures:

- Are easily understood by contractors, state agencies, and the general public.
- Focus on the performance expected from the contractor.
- Are well-defined and consider both the quantitative (how much?) and qualitative (how well?) aspects of performance.
- Include a well-defined method for reporting data.
- Are realistic in terms of available resources, funding and timelines, and recognize external factors beyond the control of the system.

Contract Management and Monitoring

The purpose of contract management is to:

- Ensure the contractor is in compliance with the terms and conditions of the contract.
- Verify the delivery of services paid for by the state and the appropriate use of public funds.
- Ensure that agencies and clients are satisfied with contractor performance.
- Resolve any issues, concerns or problems that may arise from contractors and clients related to contracts administered by state agencies.

The specific nature and extent of contract management varies from contract to contract, and should be tailored to the type of contract and contractor involved. Factors which may influence the approach to contract management include the nature of the work; the size, complexity and sensitivity of the contract; experience of the contracting parties; and contractor performance.

Contract management and monitoring responsibilities should be carried out by the individual, team, or entity that has the necessary expertise and authority to assess service quality and enforce contract provisions. Typical responsibilities may include:

- Understanding the contract including the respective contract obligations and performance indicators by which performance will be monitored.
- Ensuring that the contractor has a good understanding of how the contract will be managed and monitored.
- Monitoring the performance of the contractor against the contract terms and agreed performance indicators.
- Establishing and maintaining an effective working relationship with the contractor.
- Collaborating with agencies funding the same contractor.
- Providing feedback regarding contract performance.
- Maintaining adequate documentation and records of all dealings with the contractor.
- Providing or facilitating delivery of guidance, training or technical assistance to ensure contract performance and compliance.
- Addressing issues that arise during the contract and agreeing on methods for resolving problems.
- Exercising contract remedies, as appropriate, when the contractor's performance is deficient.
- Seeking specialist advice when unsure of the rights of either party or the correct application of the contract.
- Verifying the contractor has fulfilled requirements of the contract before approving invoices for payment.
- Monitoring payments against contract terms.
- Processing invoices for timely payment in accordance with state laws, the contract, and agency policies.

Monitoring

Monitoring is defined as the examination, analysis, and verification of the contractor's performance. Monitoring includes planned ongoing or periodic activities such as reviewing, observing, and documenting outcomes in accordance with the contract and reporting. The primary responsibility for performance of the contract rests with the contractor. However, it is critical that the state agency monitor its contracts for adequate performance to protect both the state's and the clients' interests. Effective monitoring can also assist in identifying and reducing fiscal and program risk as early as possible, thus protecting both public funds and the clients being served. Monitoring should be viewed as a preventative function; an opportunity to determine the need for and provide technical assistance; and a valuable source of information concerning the effectiveness of services and service delivery methods. The contractor should be

considered a strategic partner and encouraged to innovate, improve, and deliver better customer service.

Each agency should have a system to ensure ongoing review and verification of:

- The contractor's performance and compliance with the requirements of the program.
- Adherence to applicable laws and regulations.
- Progress toward the expected results and outcomes specified in the contract.

State agencies are responsible for determining the methods needed to effectively assess and evaluate contractor performance and compliance.

Risk Assessment Approach to Monitoring

It is not realistic to expect monitoring of every requirement of every contract. A risk assessment is a useful tool to determine the level of monitoring effort appropriate for a specific contract.

State agencies are encouraged to use a risk-based approach to determine the level of review needed, target monitoring efforts to areas of greater risk, and prioritize contractors for monitoring purposes. A risk assessment evaluates risk factors such as the agency's experience with the contractor, contractor systems and controls, changes in operations or personnel, the history of the specific program or service, and other appropriate indicators of risk based on the knowledge and experience of state agencies. Risk factors can be broken out into three broad categories:

- Risks associated with a particular program.
- Risks associated with a particular provider.
- Risks associated with the state agency.

Risks associated with a particular program: Programs differ in their inherent risks. Examples of risk factors that may be related to a program include:

- History – is it a new or long established program or service? Have any significant changes occurred?
- Complexity – are the requirements simple or complex?
- Sensitivity – how vulnerable are the clients the program serves?
- Responsibility for key decisions – are decisions about eligibility and amount or type of service to be provided to a client made by the state agency or the contractor?
- Payment method – what type of payment method is used (for example, cost reimbursement, fee for service, performance based)? What experience does the state agency have with this method? All payment methods have risks, depending on the circumstances.

- Competition – was the contract awarded on a competitive basis, which included detailed evaluation of the service proposal, costs, and contractor qualifications, or was it awarded on a noncompetitive basis?

Risks associated with a particular provider: Contractors also have inherent risks. Examples of risk factors that may be related to a provider include:

- Total funding from the agency – is the amount of funding small or large? Does the contractor have many or few contracts with the state?
- Multiple funding sources – is the full cost of the service paid for by a single funding source or is the contractor using several funding sources?
- Collaboration – has the contractor promoted collaboration on service delivery and contract expectations between itself and all of its funding partners?
- Length of time in business – has the contractor been in business for several years or is it a start-up?
- Experience and past performance – how extensive is the contractor's experience with this type of service? What is their performance history? Have there been changes in key staff?
- Financial health and practices – is the contractor's financial condition good or poor? Does it have a history of financial difficulties? Does it demonstrate sound financial practices? Is the contractor's financial record keeping system adequate for the number and complexity of fund sources being managed? Does it do business with related parties and, if yes, does this business affect agency funds?
- Compliance and internal controls – what is the history of compliance and internal controls? Does the contractor's audit report show weaknesses or findings of noncompliance? Do the same findings recur year after year? Does the contractor have adequate segregation of duties?
- Board of directors – if the contractor is a nonprofit organization, does the board take an active role in directing the organization, establishing management policies and procedures, and monitoring the organization's financial and programmatic performance? Is the board made up of unrelated individuals? Do employees of the organization serve as board members?
- Subcontracting – does the contractor subcontract key activities? Does it have an effective monitoring function to oversee these contracts?

Risks associated with the state agency: State agencies differ in their experience contracting with particular programs or contractors and in the availability and effectiveness of their monitoring efforts. Examples of risk factors that may be related to a state agency include:

- Experience with the contractor – has the agency worked with the contractor before or is it a new contractor? What has been the result of prior contracts, monitoring efforts, and audits?
- Experience with the program – what type of experience does the agency have with this program or service?

- **Monitoring methods** – does the agency have well-established methods of monitoring? Do these monitoring methods effectively mitigate the other types of possible risks?

Based on the results of the risk assessment, the agency should determine the scope, frequency, and methods of monitoring to be used that ensure sufficient oversight given the risks involved. Risk assessment results may also be used to devise more stringent controls and tighter contract language, when appropriate, to adequately monitor the use of contracted funds.

Monitoring Plan

One means of defining the specific monitoring methods appropriate to a particular program or service and the monitoring activities to be completed for an individual contractor is a monitoring plan. The plan will identify the tools to measure and assess contract performance and compliance, and the process for collecting information. The plan can also enable an agency to assess the contract management resources necessary to ensure adequate oversight. The level of monitoring, as included in the plan, should be commensurate with the importance or sensitivity of the service. Further, the plan can identify how monitoring activities will be coordinated between multiple state agencies providing funding to a contractor. Ideally, the monitoring plan will be prepared concurrent with the contract to ensure consistency and that contract requirements support the planned monitoring activities.

It is not required, or even desirable, that every contractor receive the same level of attention. Generally, contractors who receive more money, who have a history of problems, and/or who are new will require more monitoring than those who have smaller dollar value contracts and/or have a good track record with the agency. Where monitoring results demonstrate consistent good performance, the amount of monitoring may be adjusted accordingly. This saves the state money, reduces oversight burdens on the contractor and recognizes the contractor's achievement of performance.

Monitoring plan activities may include:

- **Periodic contractor reporting:** Require the contractor to submit progress or other appropriate data or reports based on pre-defined criteria.
- **Agency review of contractor reports:** Review the contractor's data or reports for verification of services provided and adherence to the contract. Substandard performance must be identified and addressed in a timely way.
- **Invoice audits:** Compare billings with the terms agreed upon in the contract. Ensure the costs being charged are within the contract parameters.
- **Onsite reviews and observations:** Conduct onsite reviews/observations to interview contractor staff and clients, review key systems and service documentation, and observe operations whenever possible. The results of these visits should be reported and compared with contract requirements.
- **Other periodic contact with contractor:** Maintain contact with the contractor to review progress on a regular basis. Good contract monitoring includes a continuous dialogue with the contractor.

- **Customer surveys:** Survey customers concerning service delivery and quality. Require the contractor to resolve customer complaints. Keep records of both the complaint and method of resolution.
- **Corrective action:** Verify whether the contractor has completed corrective action plans including procedures to address noncompliance or inadequate performance on the part of the contractor. A written record of the actions taken should be maintained. If corrective measures are not completed by the contractor in a timely manner, the agency should take prudent action to reduce the risk of loss to the state. Such action may include, if necessary, withholding payment from the contractor, requesting partial reimbursement of funds already distributed or termination of the contract.

Monitoring involves prudent collection of needed information about contractor operations and is not limited to site visits or the completion of formal reviews. Every communication with a contractor is an opportunity to document monitoring activity. Adequate documentation is essential for program monitoring. Contract files should include copies of letters, meeting notes, and records of phone conversations as evidence that conscientious monitoring has occurred during the life of the contract.

Contract Cost and Financial Provisions

Every client social service contract should specify the method of compensation to be used to pay the contractor for the delivery of services. Contract terms should clearly spell out the documentation requirements, and billing and payment procedures relevant to the compensation method used. Typical compensation structures include:

- **Cost reimbursement:** The contractor is reimbursed on the basis of its actual costs incurred in providing the services based on an approved budget specifically authorized in the contract. Allowable and unallowable cost provisions should be clearly identified in the contract. The contract generally includes a maximum allowable compensation level for the contract period.
- **Fee for service:** The contractor receives a set fee for delivering a defined unit of service based on a rate authorized by the contract. The contract may or may not specify a maximum allowable compensation. The fee may be based on an established rate structure set by law, regulation or policy, or may be based on cost information provided by the contractor during a competitive solicitation or contract negotiation.
- **Fixed price or lump sum:** The contractor receives a set fixed amount or lump sum payment based on terms established in the contract. Typically, payment is tied to completion of agreed upon performance; however, other alternatives (such as lump sum payments made to compensate for activities conducted during a specific period of time) are possible. The contract generally establishes a maximum allowable compensation.
- **Performance based:** Performance based contracts are based on attainment of specific outcomes (for example, placement of a client into unsubsidized employment). The rate of compensation is generally negotiated based on cost information provided by the contractor.

In some cases, the rate may be set by agency policy or other means. Generally, performance based contracts identify the maximum allowable compensation.

The method used to determine contractor reimbursement should ensure that the state pays a fair and reasonable price for services. Prior to the contract award, the services should be analyzed to determine the most effective method of payment. Ideally, the compensation structure selected will be one which best supports delivery of outcomes, rewards motivation, encourages efficiencies and effectiveness of service, and provides the best value to customers. In some cases, the compensation structure may include a mix of payment methods as described above. For example, the method of payment may be based primarily on attainment of specific performance targets but could also include a periodic fixed or lump sum payment to ensure the contractor has funding sufficient to meet core operating requirements.

If subject to negotiation, proposed contractor budgets or rates of reimbursement should be reviewed to ensure that the level of compensation is reasonable and necessary to accomplish agency objectives. Agencies should consider whether there is a reasonable correlation between the quality of service provided and costs of providing the service as identified by the contractor.

The method of payment selected may have an impact on the level and type of monitoring activities required to ensure that the state received the services contracted for and, where specified, the funds are used as intended. Contracts with a cost reimbursement compensation structure or contracts that use multiple funding sources, particularly those supported with federal funds, are likely to require a higher level of monitoring than contracts using the other payment methods described.

General Cost Principles

Contract funds may only be used for allowable costs. When determining whether a cost is allowable, the agency should consider the general principles for allowability as described in the next section, applicable federal cost principles, or other provisions applicable to the particular program. Specific statutory provisions, administrative rules, agency policy, or federal regulations may require exceptions to the principles described in this guide. Where exceptions occur, they should be specifically indicated in the contractual agreement between the state and the contractor.

In no instance should the same cost be reimbursed more than once. Similarly, costs for the same service, taking into account the service time period should not be paid by more than one funding source. If the costs for services provided are to be distributed among several funding sources, the costs should be proportionally distributed. Agencies should ensure that the cost distribution method is well understood, documented, and agreed to by the contractor and funders of the service prior to the contract start date.

General Principles for Allowability of State Contracted Costs

In order to be allowable for reimbursement by state agencies, all costs must meet the following general criteria. A cost must:

- Be necessary and reasonable for proper and efficient program administration, and allocable under these guidelines. Only costs that are directly attributable to specific work or the normal administration of the contract, or allocable to the contract, are reimbursable.
- Be authorized by the funding agency and not prohibited by federal, state or local laws.
- Be in conformance with any limitations or exclusions set forth in federal or state laws, or other governing limitations as to types or amounts of cost items.
- Be consistent with policies, regulations, and procedures that apply uniformly to both financially assisted activities and to other activities of the contractor.
- Be accorded consistent treatment. A cost may not be assigned to a contract as a direct cost if any other cost under the same circumstances has been charged to the contract as an indirect cost.
- Be determined in accordance with generally accepted accounting principles or other accounting method appropriate to the circumstances.
- Be allocable to appropriate program(s). May not be also charged to other federal or non-federal program(s), in either the current or prior periods.
- Be net of all applicable credits.
- Be supported by the contractor's accounting records and adequately documented. See applicable U.S. Office of Management and Budget (OMB) circulars for additional information on required accounting records and source documentation for federal funds.

Reasonableness of Contracted Costs

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining the reasonableness of a given cost, where applicable, consideration shall be given to:

- Whether the cost is ordinary and necessary to the operation of the contractor or to the performance of the contract.
- The restraints or requirements imposed by such factors as sound business practices, arms-length bargaining, laws and regulations, and terms and conditions of the program.
- The market prices for comparable goods and services.
- Whether the individuals involved acted with prudence considering their responsibilities to the entity, the state contracting agency, and taxpayers.
- Whether the costs were incurred in accordance with the contractor's established policies.

Federal Cost Principles

Contracts supported with federal funds are subject to federal cost principles that provide guidance on the allowable and unallowable costs. The chart below lists cost principles that apply to different types of organizations (such as, local government or Indian tribe, nonprofit entity, educational institution or for-profit entity).

For the costs of a –	Use the principles in –
State, local or Indian tribal government	OMB Circular A-87 Cost Principles for State and Local Governments
Private non-profit organization other than an (1) institution of higher education, (2) hospital or (3) organization named in OMB Circular A-122 as not subject to that circular	OMB Circular A-122 Cost Principles for Nonprofit Organizations
Higher educational institution	OMB Circular A-21 Cost Principles for Higher Educational Institutions
For-profit organization other than a hospital and an organization named in OMB Circular A-122 as not subject to that circular	48 CFR Part 31 Contract Cost Principles and Procedures, or uniform cost accounting standards that comply with cost principles acceptable to the awarding agency
Hospital	45 CFR Part 74, Subpart E, or other cost principles acceptable to the Federal agency

The applicability of the cost principles flows through to the subrecipient. The type of recipient or subrecipient determines the applicable cost principles, regardless of whether the funds are received directly from the Federal government or through a subaward from a primary recipient (such as the State of Washington).

The exception to the cost principles is where statutory or regulatory provisions applicable to the prime recipient are more restrictive than the cost or administrative principles applicable to the subrecipient. If a statute passed by Congress prescribes policies or procedures that differ from those in the Circular, the provisions of the statute govern. For example, it is not uncommon for Congress to enact legislation that restricts certain items of costs (such as, limitations on indirect or administrative costs). Where such a restriction exists, it is binding. Accordingly, state agencies should exercise care in applying Circular definitions when making judgments about the effect of statutory limitations.

Cost Allocation

The total cost of a contracted service is comprised of the allowable direct costs required for performance of the service plus its share of the allowable allocated and indirect costs. Cost allocation is the process of dividing these types of costs between the funding sources available to the contractor in accordance with the relative benefit received.

- **Direct costs** are those which can be identified with a particular contract, program, or cost objective. For example, the entire salary of an individual who spends all of his or her time working on a single contract can be charged as a direct cost to that contract.
- **Allocated costs** are costs that directly benefit more than one contract, program, or function and can therefore be allocated to the benefiting programs based on some reasonable and equitable basis. For example, an individual spends his or her time working on a number of different contracts for the contractor. The salary and benefits for that person can be charged to the respective contracts as an allocated cost based on the number of hours reported to each contract on time sheets. Allocated costs should be distributed based on actual expenditures; an allocation based on available budget is not acceptable.
- **Indirect costs** are costs incurred by a contractor that are not readily chargeable to a particular contract, program, or function, but benefit all programs operated by the contractor. Indirect costs are necessary to the overall operation of the contractor, but a direct relationship to a specific contract cannot be shown. An example of an indirect cost might be the salary and benefits, space costs, and supplies for the contractor's accounting department. Generally these kinds of costs are identified, pooled and charged to different funding sources using a rate designed to recover the costs. This is called an indirect cost. The indirect costs applied to a contract should be based on the relative benefit received. Indirect cost allocation plans should be coordinated and approved by all funding agencies prior to the start of contract service delivery.

Increasingly, the costs of delivering a service or set of services may be distributed by the contractor to more than one contract or funding source. As a result, state agencies should request information from contractors on all the contractor's funding sources to gain a complete understanding of the funding that will be used by the contractor to meet its contractual service obligations for the specific contract being developed.

When the contractor will be paid on a cost reimbursement basis and will be using other funding sources in addition to those provided under the agency's contract, agencies should request from the contractor a description of its methodology for assigning costs to each funding source. Such a description may include:

- Period of time covered by the plan.
- Cost items to be allocated.
- Allocation method.
- Funding sources to which costs are allocated.

When multiple funding sources are used, it may be necessary to think through the compliance and documentation impacts to ensure that allowable costs are in the aggregate only billed once. Appropriate guidance should be provided to the contractor, prior to the contract start date, for any special compliance, documentation, or other requirements related to the use of multiple funding sources.

Fiscal Monitoring

The scope of fiscal monitoring applied to a specific contract will vary, depending on various factors, including:

- The method of contract compensation.
- The financial management requirements for the source of funding used to support the contract.
- Monitoring requirements established by law, policy or practice.
- Results of a risk assessment, prior monitoring activities or audits.
- Use of multiple funding resources.
- Other considerations as identified by the agency.

Key principles that an agency should keep in mind when considering the fiscal monitoring needs of any contract include:

- State agencies are accountable for ensuring that cost-effective, quality services are provided to their clients by agency contractors.
- State agencies are responsible for ensuring that public funds are used as intended and in accordance with applicable laws, regulations, and contract provisions.
- Contractors are accountable for maintaining internal controls and financial systems that ensure funds are accounted for and spent in compliance with relevant requirements.
- State agencies and contractors are to maintain adequate safeguards to prevent misuse or misappropriation of funds provided through state administered contracts, and to ensure the same service delivery costs are not billed to more than one funding source.

The most basic level of fiscal monitoring is the review of the contractor's invoices and documentation required to support the billing submitted. Before authorizing payment, the agency should ensure the contractor has adequately demonstrated the satisfactory delivery of services as agreed to in the contract. In addition to verifying the accuracy of the contractor's billing and documentation, and its consistency with contract requirements, the agency should ensure that total payments are within the limits set by the contract.

Most of the fiscal monitoring activities related to reviewing contractor invoices is completed as desk level monitoring. However, agencies may wish to make periodic site visits to conduct additional review tests to verify service delivery as reported by the contractor.

Contracts with fee-for-service, fixed price, or performance based compensation structures may require no further fiscal monitoring. Cost reimbursement contracts are likely to be subject to further testing which may be conducted using contractor self assessment tools, additional desk level review of contractor reports and documentation, site visits, or a combination of these methods. Appropriate fiscal monitoring procedures should be determined as needed. Again,

decisions regarding the scope and methods to be used should take into account requirements that may be established by the funding source, risk assessment results and other relevant factors.

Contractors that rely on use of multiple funding sources, or deliver multiple similar services may also require a higher level of monitoring to verify that costs are being allocated in conformance with agreed upon cost allocation plans.

Timely Payment

Due dates for payments are generally established by the terms of the contract between the agency and its contractors. If the contract is silent concerning terms, the standard terms are net 30 days. The 30 days begin upon receipt of a properly completed invoice, including appropriate documentation when necessary, based on the requirements contained in the contract.

All payments should be made by the due date. As required by Chapter 39.76 RCW, state agencies, if billed, are required to pay interest at the rate of one percent per month on past due accounts.

Due dates are postponed in the case of disputes. If there is a good faith dispute, the agency should provide prompt notification to the contractor in accordance with contract provisions or RCW 39.76.020(4).

In some cases, the contractor may be required to obtain prior authorization from the state agency to provide client services. Agency policies and contract terms should specify how such authorization needs to be documented. Agency action to appropriately document service authorization may need to occur before the contractor is able to submit its billing to the agency. When this is the case, state agencies are strongly encouraged to ensure that service authorization documentation is completed in a timely manner.

Contractors with limited financial reserves could be adversely impacted by the failure of the state agency to fulfill its obligations in a timely manner. It could also have an impact on the contractor's ability to provide services or meet their contract obligations. Ensuring timely payment is in the state's best interest.

AUDIT

Contractors who receive social service contracts are responsible for complying with federal and state requirements associated with the funds used to provide services. This responsibility includes having an audit when required.

Social service contractors will typically be required to meet audit requirements in two instances:

- A federal single audit is required when the contractor is a nonprofit or local government entity, is considered a subrecipient of one or more federal awards, and has spent \$300,000 or more in federal funds during its fiscal year.

- When the contractor meets the subrecipient definition and the state agency program has elected to require an audit as a condition of the contract.

There are several different types of audits. The most standard ones are: 1) financial audit; 2) limited scope or agreed-upon procedures audit; and 3) OMB A-133 federal single audit. Each type is defined below.

In order to meet the needs of government users, each type of audit should be performed in accordance with the Generally Accepted Government Auditing Standards (GAGAS) established by the American Institute of Certified Public Accountants and the standards applicable to financial audits established by the Comptroller General of the United States. (GAGAS is not applicable to all audits, but applies to governmental agencies and not-for-profits when they receive sufficient federal funds.)

Financial audit: a federal or state financial audit is an examination of an organization's books and records. The results of a financial audit are an expression of opinion by the independent auditor on the fairness of the presentation of the financial statements and conformity with Generally Accepted Accounting Procedures (GAAP).

Limited Scope or Agreed-upon procedures audit: in a limited scope or agreed-upon procedures engagement, the contracting agency defines the specific auditing procedures required.

Generally, the agreed-upon procedures audit will examine specific program compliance and internal controls requirements (for example, allowed and unallowed activities, allowable costs, eligibility, or reporting). The auditor's report for a limited scope or agreed-upon procedures audit will include a description of the procedures followed and the findings which resulted. This type of audit provides approximately the same level of testing and assurance as would be achieved with a program audit, but substantially less than an agency-wide single audit.

OMB A-133 Federal Single audit: a federal single audit may be required when an organization expends federal funds. A single audit is a financial, internal control and compliance audit completed on an entity as a whole. The result of a single audit is an expression of opinion by the auditor on the fairness of the financial statements and conformity with GAAP; a report on internal control related to the financial statements and major federal programs; and a report on compliance with laws, regulations and provisions of a contract or grant agreement.

If an organization spends federal funds under only one federal award, the entity may elect to obtain a program specific audit instead of a single audit. The result of a program specific audit is the same expression of opinion by the auditor as in a single audit, except it relates only to the specific program.

Federal Audit Requirements for Federally Funded Contracts

Contractors that are a state agency (including state colleges and universities), local government, or nonprofit entity, meet the subrecipient definition and expend \$300,000 or more in federal funds during their fiscal year are required to meet the single audit requirements contained in Circular A-133, Audits of States, Local Governments and Non-Profit Organizations issued by the

U. S. Office of Management and Budget (OMB). In most instances, entities subject to A-133 will receive an annual, entity-wide single audit. However, if the entity spends federal funds under only one program, the entity may elect to have a program specific audit.

The State Auditor's Office conducts an annual statewide single audit that satisfies A-133 requirements for all state agencies, including higher education institutions. If the contractor is a local government, the audit will be conducted by or under the supervision of the State Auditor's Office. A-133 audits of nonprofit contractors are conducted by a qualified independent auditor selected by the contractor.

The overall objectives of an A-133 single audit are to determine whether:

- The financial statements of the contractor present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;
- The contractor has adequate internal fiscal and management control systems to provide reasonable assurance that it is managing federal financial assistance programs in compliance with applicable laws, regulations and contract requirements; and
- The contractor has expended federal funds in accordance with the terms of applicable agreements and has complied with laws, regulations, and requirements that may have a material effect on its financial statements.

A single audit, prepared in compliance with A-133 requirements, will include the following elements:

Financial

- Independent auditor's opinion on the financial statements
- Schedule of expenditures of federal awards

Internal control

- Report on internal control structure related to the financial statements in accordance with generally accepted government auditing standards
- Report on internal controls regarding major programs

Compliance

- Report on compliance with laws and regulations

Other

- Schedule of findings and questioned costs
- Summary schedule of prior audit findings
- Corrective action plan

Subrecipient definition

Single Audit Act requirements for state contracts supported with federal funds apply only to contractors that meet the definition of a subrecipient. One of the more challenging tasks facing

state agencies that contract for social services is determining whether a contractor is a subrecipient or a vendor. Judgment must be used to determine the type of relationship applicable to a contract agreement; the substance of the relationship is more important than the form of the agreement. Additional guidance to assist state agencies in distinguishing between subrecipient and vendor relationships is available in the State Administrative and Accounting Manual (SAAM) issued by the Office of Financial Management (A copy of SAAM is available on the internet at <http://www.ofm.wa.gov/policy/saamintro.htm>).

Audit requirements for state contracts supported with federal funds apply only to contractors that meet the definition of a subrecipient. Washington state has also elected to base its audit requirements for state-funded contracts on the federal subrecipient definition.

A subrecipient is any nonfederal entity that receives financial assistance, directly or through a pass-through organization such as a state agency, to carry out or administer a program. Distinguishing characteristics of a subrecipient include, but are not limited to, the following:

- Responsibility to meet applicable compliance requirements;
- Responsibility for programmatic decision making;
- Performance is measured against meeting the objectives of a program; and
- Determining eligibility for assistance.

Contractors that do not meet these criteria are considered vendors. A vendor is an entity responsible for providing generally required goods or services related to the support of the federal assistance program. Distinguishing characteristics of a vendor may include:

- Providing the goods or services within normal business operations;
- Providing similar goods or services to many different purchasers;
- Operating in a competitive environment; and
- Is not responsible for adhering to program compliance requirements.

Audit Requirements for State Funded Social Service Contracts

Washington State has a modified single audit requirement similar to the federal single audit requirement for social service contracts supported with state funds. However, the Task Force on Agency Vendor Contracting Practices is recommending that the Legislature repeal this statute and use the alternative risk assessment approach to determine the contractors that need to be audited and to set audit requirements.

Each agency program will be responsible for establishing a consistent risk assessment framework that takes into account relevant factors which may apply to their program or contractors. Guidance on developing and using risk assessment criteria is provided in the Contract Management and Monitoring section of these guidelines. State contract audit requirements should take into account and avoid duplication of audit procedures that would be performed as a result of other audit requirements applicable to the contractor (for example, A-133 audit requirements).

Based on the results of the agency's or program's risk assessment, audit requirements should be incorporated as needed in the contract agreement. The contract should specify audit expectations in sufficient detail to enable the contractor and its independent auditor to know, in advance, compliance requirements and auditing procedures to be applied.

While an audit requirement may be an important feature of an agency's or program's contract oversight system, it should not be used to replace other types of monitoring. Audits do not tell the contracting agency or program about the quality or appropriateness of the contractor's services. By their nature, audits do not provide complete assurance that funds are being administered properly. Finally, the contractor's audit report will typically be submitted several months after the beginning of the contract, which means significant problems may occur during that time if the agency relies just on the audit to monitor the contract. State agencies need to perform monitoring during the life of the contract in order to ensure that funds are administered appropriately.

AUDIT REVIEW AND RESOLUTION

Audits serve as an important feedback mechanism on the management and financial operation of government funded programs. State agencies are expected to give priority to the resolution of audit recommendations and to corrective action related to findings contained in independent auditor reports.

Federal Single Audit Act Responsibilities

Based on the federal Single Audit Act and OFM policies, state agencies have several key responsibilities related to the receipt and review of contractors' OMB A-133 audit reports, and, if needed, resolution of audit findings related to the contracts administered by their agency:

- Ensuring that contractors comply with applicable audit requirements and provide audit reports and corrective action plans, when required, in a timely manner;
- Reviewing audit reports for completeness and adherence to audit standards, and advising the auditor, and the contractor where appropriate, of any deficiencies found in the audits when the deficiencies require corrective action by the auditor;
- Evaluating the audit findings and corrective action plan submitted by the contractor and the impact of the findings on agency programs;
- Issuing a written management decision on audit findings within six months after receipt of the audit report; and
- Following up to ensure that the contractor takes appropriate and timely corrective action, including repayment of funds or other action as may be needed.

Audit issues

One of the primary purposes of an audit is to determine whether the contractor's costs and revenues are allowable under the contract and program requirements. Accordingly, the audit

report is to identify costs and revenues which the auditor finds are ineligible or otherwise improper as part of the contract.

Questioned costs normally fall under the following categories:

- Costs which are specifically unallowable under the relevant program and contract conditions or instructions;
- Costs which are not reasonably documented as being related to the program or contract;
- Costs which have been charged to more than one program or funding source;
- Costs including the valuation assigned to any cash equivalent (in kind) contributions which appear to be unreasonable in light of evidence reviewed by the auditor; and
- Costs requiring formal written approval by the funding state agency but where no evidence of approval is available.

Questioned costs will be presented in a schedule of findings and questioned costs.

Additional audit issues that may affect agency programs include findings other than questioned costs (fraud, findings of noncompliance, reportable conditions or material weaknesses), weak financial condition or other matters of concern to the state agency.

Auditors may also issue a management letter. This is a good place to look for potential problems. It will cover general suggestions that may or may not be considered applicable to management. But it will also include items which were not considered material to the financial statements, but may be of interest for monitoring purposes.

Audit review

State agencies should perform desk reviews of audit reports of their contractors. The purpose of the desk review is to determine whether the audits meet the applicable standards and whether issues disclosed in the audit report affect the agency's programs. The desk review should be documented as the State Auditor's Office and others (internal auditors, federal funding agencies) may review the agency's monitoring efforts, which includes review and resolution of audit reports.

Agency management decisions and corrective actions must be consistent with law, regulations, contract terms and conditions, and policies established by the agency, the Office of Financial Management, the federal government, and other oversight entities as applicable. The management decision needs to clearly state whether or not the audit finding is sustained, the reasons for the decision and the expected contractor action to repay disallowed costs, make financial adjustments, or take other action. If the contractor has not completed corrective action, a timetable for follow up should be given. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.



Appendix C: Current Law Governing State Social Services

Contract Administration Function	Responsible Agency	Existing Legal Frame Work (Law, regulation or policy and its effect)
Authority to contract	All agencies All agencies All agencies Agency specific	<ul style="list-style-type: none"> Agency's enabling legislation generally includes authority to contract RCW 41.06.380 – state civil service law contracting limitations RCW 43.17.065(1) – expeditious exercise of power to issue permits, licenses, certifications, contracts and grants Agency and program specific laws providing authority or limitations
Contract procurement	All agencies All agencies All agencies	<ul style="list-style-type: none"> Chapter 39.29 RCW – personal service contracts RCW 39.29.040 – exempts client service contracts from provisions of Chapter 39.29 RCW Chapter 42.52 RCW – ethics in public service
Contract negotiation and approval	All agencies	<ul style="list-style-type: none"> RCW 43.88.130 – contracts in excess of amount appropriated for that purpose prohibited
Contract management and monitoring	All agencies	<ul style="list-style-type: none"> RCW 43.88.160(4)(a) – internal controls and internal audits
Contract payment and financial provisions	DSHS DSHS All agencies OFM State Treasurer All agencies	<ul style="list-style-type: none"> RCW 43.20A.405 – authority to establish rates of payment for purchased services (DSHS only) RCW 43.20B.675 – vendor overpayment provisions (DSHS only) RCW 43.88.140 – lapsing of appropriations RCW 43.88.160(1) – directs OFM to establish statewide accounting systems and manual (SAAM) RCW 43.88.160(5) – requirements for disbursement of public funds RCW 43.88.260 – cash deficiencies prohibited

Contract Administration Function	Responsible Agency	Existing Legal Frame Work (Law, regulation or policy and its effect)
Audit	State Auditor State Auditor State Auditor State Auditor State Auditor	<ul style="list-style-type: none"> • RCW 43.09.055 – audits of entities with state contracts or grants when there is reasonable cause to believe a misuse of state funds • RCW 43.09.065 – audits of state entities with state contracts or grants, report regarding criminal misuse of public moneys • RCW 43.09.310 – post-audit of state agencies • RCW 43.88.160(6) – audit of financial transactions and provisions for exceptions to specific expenditures • RCW 43.88.570 – audits of contracts for social services provided by nongovernment entities receiving state funds
Other	All agencies All agencies All agencies All agencies Attorney General Legislative Auditor, Attorney General	<ul style="list-style-type: none"> • RCW 43.88.200 – agency financial transaction records deemed public records • RCW 43.88.205 – notice of agency contracts for federal funds • RCW 43.88.220 – allows federal requirements which are a condition to receipt of federal funds to supersede Chapter 43.88 RCW provisions • RCW 43.88.290 – fiscal responsibilities of state officers and employees, prohibitions relative to appropriations and expenditures • RCW 43.88.300 – fiscal responsibilities of state officers and employees, violations, civil penalties and forfeiture • RCW 43.88.310 – fiscal responsibilities of state officers and employees, duties of legislative auditor, attorney general



Appendix D: Issue Paper

TASK FORCE ON AGENCY VENDOR CONTRACTING PRACTICES CONTRACT LEGAL REMEDIES AND/OR SANCTIONS

ISSUE

Should the Task Force on Agency Vendor Contracting Practices recommend contract legal remedies and/or sanctions?

BACKGROUND

The House Select Committee on Vendor Contracting initiated legislation in 1998 to study current state contracting practices for social services after concerns were raised of misuse of funds by nonprofit entities. The legislation authorized the office of Financial Management (OFM) to convene the nine-member Task Force on Agency Vendor Contracting Practices comprised of two members representing contractors, two members with work experience as state employees, and the remaining members knowledgeable and experienced with state agency contract practices.

The Task Force focused its work on the issues and problems deemed most critical with the objective to offer workable, practical solutions that would reduce or prevent future problems. They reviewed current state social service contracting practices, researched contracting practices in other states, conducted surveys, held focus groups and solicited input one-on-one from state contractors, agency staff and other stakeholders that have hands on experience with state contracts.

The Task Force discussed contract legal remedies and sanctions which could be imposed on contractors and requested OFM staff to conduct further research. This Issue Paper summarizes the research. Upon review, the Task Force determined not to make a formal recommendation until an in-depth public policy analysis could be completed and interested parties could be given an opportunity to comment. The Task Force then recommended that the issue be addressed by the Interagency Quality Improvement Team.

ANALYSIS

There are many models for progressive punitive damages in the country. The state of Washington also has some program specific models. The Washington models typically deal with situations where a license is required or mandatory prequalification to bid. This paper will briefly discuss the different models and the general experience of the agencies or programs that use them.

Termination for default clauses are commonly used in state contracts. This provision allows the state to terminate a contract based upon the other party's default. The state must demonstrate that there has been a material breach in one or more of the terms or conditions of the contract. By invoking the termination for default clause, the agency is generally in a position to claim damages due to the other party's breach of contract. Because DSHS serves a vulnerable population, DSHS has a slightly different termination for default provision. DSHS's clause may be invoked if DSHS has a reasonable basis to believe that the contractor has: 1) Failed to meet or maintain any requirement for contracting with DSHS; 2) Failed to perform under any provision of the contract; 3) Failed to ensure the health or safety of any DSHS client for whom services are being provided under the contract; 4) Violated any applicable law, regulation, rule, or ordinance; and/or 5) Otherwise breached any provision or condition of the contract. Additionally, DSHS may withhold a sum of money from the final payment to the contractor in an amount that DSHS determines necessary to protect DSHS against loss or additional liability. Normally an Assistant Attorney General is involved in a termination for default.

The Department of Social and Health Services (DSHS) in its licensing requirements for adult family homes has a progressive series of actions that can be employed when a provider has failed to comply with the applicable requirements. The first step is to provide consultation and an opportunity for the provider to take corrective action unless the violations poses a serious risk to residents, are recurring or have been uncorrected. Another step is to impose the requirements of correcting the situation within a reasonable time, training, and/or limits on the type of residents the provider may admit or serve. DSHS, which has statutory authority to assess civil penalties, can impose civil fines. If the contractor does not pay the civil fines within a specified period of time, DSHS can withhold an amount equal to the fine plus interest, if any, from any contract payment due to the provider. As a final option, DSHS can also proceed with an order to stop placement in which the provider is prohibited from admitting any person until the deficiency is corrected and the stop placement order is terminated. Additionally, the provider's license can be suspended or revoked. Daycare licensing and juvenile community facilitates licensing regulations also have similar types of actions available. The combination of these remedies has been effective in these specific licensing situations.

The Department of General Administration, Office of State Procurement (OSP), is the state's central purchasing authority for purchased goods and services. OSP has the authority to remove a vendor from the bidders list. This action has been used a few times over the years when the vendor has repeated flagrant violations and has shown little or no desire to take corrective action. Rather than remove a vendor from the list, the preferred method has been to make award decisions based upon the criteria outlined in RCW 42.19.1911. This allows the agency to reject bids based upon a number of factors impacting "supplier responsibility", including previous performance, previous or existing compliance with laws relating to the contract or services, ability, capacity, skill, integrity, reputation, judgment, experience, and efficiency of the bidder. In addition, OSP can invoke termination procedures or impose other remedies as outlined in the contract.

The Office of Minority and Women's Business Enterprises has progressive remedies that can be invoked when a person or entity does not comply with Chapter 39.19 RCW or with a contract requirement established under that chapter. The actions are, withhold payment, terminate the

contract, assess a civil penalty for each violation, suspend or debar the contractor. Willful repeated violations, exceeding a single violation, may disqualify the contractor from further participation in a state contract for a period of up to three years. The more severe penalties have only been used in a limited number of situations where the agency and contractors could not resolve the problems. However, the process has been effective in bringing contractors into compliance short of suspension or debarment.

Under the Prevailing Wages on Public Works statute, 39.12 RCW, the Department of Labor and Industries (L&I) and/or the awarding agency have certain remedies available. If the contractor or subcontractor has not paid wages at the correct rate established in RCW 39.12.020, and a finding to that effect has been made, such unpaid wages will constitute a lien against the bonds and retainage of the contractor. For false filings or failure to file, a civil penalty can be imposed and the contractor or subcontractor can be prevented from being awarded a contract until the fine has been paid in full. If a contractor or subcontractor is found to have violated these provisions a second time within a five year period, the contractor or subcontractor is not allowed to bid on any public works contract for one year. Normally the agency and the contractor settle the matter with the contractor paying the difference in wages. In the few instances where the agency has not been able to settle the matter, lengthy legal actions were involved, sometimes taking up to three years to resolve.

The Department of Transportation (DOT) has very specific and detailed statutory authority to suspend or revoke the prequalifications of a contractor. Contractors must be prequalified by DOT before they are allowed to bid on a DOT highway construction contract as detailed in RCW 47.28.070. DOT has the authority to suspend or revoke a contractor's qualifications to bid on a contract, however this provision is not used very often. Staff believes careful prequalification screening has reduced the need to invoke this provision. DOT, also has Prime Contractor Performance reports that have the standards and procedures for this report detailed in WAC 468-12-150. This report is an integral part of the prequalification process. A less than standard overall score on a final report can impact a contractor's ability to bid on future jobs. A less than standard report would be reason to deny an increase in work class rating and/or maximum bidding capacity. A higher than standard rating could make a contractor eligible for an increase in the factor used to determine maximum bidding capacity and/or increased work class rating. A below standard rating on successive projects could result in the contractor being placed in a conditional status. DOT staff believes that this report encourages contractors to perform at a higher level. This process is successful for this specific type of contract, probably due to the well established construction industry standards and the specificity of the law.

In Florida, the Department of Children and Family Services, in its authorizing statute, specifically defines the responsibilities of the agency's contracting practices. The statute provides that the department may allow a reasonable period for the provider to correct performance deficiencies. If performance deficiencies are not resolved to the satisfaction of the department within the prescribed time, and if no extenuating circumstances can be documented by the provider to the department's satisfaction, the department must cancel the contract with the provider. The department may not enter into a new contract with that same provider for the services for which the contract was previously canceled for a period of at least twenty-four months after the date of cancellation. Florida also has statutory provisions that govern a

“Convicted Vendor List”. No public entity is allowed to accept any bid from, award any contract to, or transact any business in excess of a statutory threshold amount with any person or affiliate on the convicted vendor list for a period of thirty-six months from the date that person or affiliate was placed on the convicted vendor list.

At least 18 states and numerous local governments have adopted a form of the American Bar Association’s Model Procurement Code. As part of the legal and contractual remedies section, the model provides for debarment and suspension. Debarment prohibits the contractor from being considered for an award of a contract for a period of three years. Suspension is for a lesser period of time, usually three months. The causes for debarment or suspension tend to be very serious in nature. Examples of causes for debarment are: conviction of embezzlement, theft, forgery, any other offense indicating a lack of business integrity or business honesty, major violations of the ethics standards, debarment from another state or federal government, and deliberate failure to perform in accordance with the contract or a recent record of a serious failure to perform or serious unsatisfactory performance. This process can involve a substantial amount of legal work and time.

SUMMARY

There are many different punitive models. Some are specific to certain types of contracting situations, but in general there are five options. They are:

- Informal resolution by notifying the contractor of the noncompliance and giving the contractor an opportunity to remedy the problem(s)
- Termination of the contract for default
- Civil fines
- Suspension from being awarded a contract for a short period of time
- Debarment from the contracting process for a specific period of time, typically three years.

Each step involves proper notification to the contractor, opportunity for the contractor to respond to the allegations except for situations where there is a serious health or safety risk to an agency client, issuance of a decision and right to appeal. As the severity of the punitive measure increases, the amount of legal work and staff time involved also increases. Consideration should be given to the cost effectiveness of some of these remedies.

Proper contractor screening, well written contracts that clearly define the performance expectations and regular monitoring will substantially reduce the need for punitive remedies. Considering a contractor’s past performance, integrity, skill, ability, experience, reputation and efficiency will reduce the number of contracts with problem contractors and encourage other contractors to perform at a higher level.

The Task Force took a proactive approach to the administration of social service contracts. Emphasis has been placed on preventing contract problems and working cooperatively with contractors. Less emphasis was placed on the need to punish contractors after the period of performance.

The Task Force is recommending: 1) conduct of an in-depth policy analysis of the remedies and/or sanctions with cost factors considered; 2) opportunity for the public and affected state agencies to provide input and comment; and, 3) the interagency quality improvement team could oversee this process.

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